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**A Comparative Survey for Developing and Harmonizing
the Legal Framework for Franchising in Mongolia**

by

Namsrai Battulga

SUPERVISOR:

PROF. DR. BENKE JÓZSEF DSc



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DECLARATION

I, Namsrai Battulga, declare that this dissertation is my original work compiled from university library books and online educational platforms. It has not been presented and will not be given to any other learning institution for a similar or any other award.

Using the online tool Grammarly, I can confirm that my thesis was copy-edited for language, spelling, and grammar conventions.



Namsrai Battulga

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ABBREVIATIONS / GLOSSARY

CMA	<i>The Competition and Markets Authority</i>
ACL	<i>Australian Consumer Law</i>
B2B	<i>Business to Business</i>
CMA	<i>The Competition and Markets Authority</i>
DCFR	<i>The Draft Common Frame of Reference</i>
FDD	<i>Franchise Disclosure Document</i>
UFOC	<i>The Uniform Franchise Offering Circular</i>
MFIL	<i>Michigan Franchise Investment Law</i>
FTC	<i>Federal Trade Commission</i>
IP	<i>Intellectual Property</i>
NDA	<i>Non-Disclosure Agreement</i>
RPM	<i>Resale Practice Maintenance</i>
PECL	<i>The Principles of European Contract Law</i>
TFEU	<i>Treaty on the Functioning of the European Union</i>
UCTD	<i>Unfair Contract Terms Directive</i>

INTRODUCTION

Research Background and Scope

Contract law is one of the most fundamental pillars of legal regulation, providing the framework for governing agreements between individuals, businesses, and other entities. The legal principles underpinning contract law validate that parties entering into agreements can rely on legal mechanisms to enforce their rights and obligations. It is a foundation for domestic and international commerce, offering legal certainty and predictability in business relationships. In Mongolia, contract law is primarily shaped by the civil law tradition, which emphasizes codified statutes and legal principles, alongside growing influences from global legal practices as the country integrates further into the international economy.¹

The modernization of Mongolia's contract law is intricately tied to the nation's broader economic and political transformation. Following transitioning from a centralized socialist system to a market-oriented economy, Mongolia has undergone substantial reforms to modernize its legal and financial infrastructure.² This shift towards a market economy necessitated a re-examination of the country's legal framework, particularly concerning private law, where contract law is pivotal in facilitating the exchange of goods, services, and capital. The introduction of the new Civil Code of Mongolia in 2002 marked a decisive moment in this reform process, as it laid down a comprehensive and modern set of legal principles governing private transactions, including contract formation, performance, and enforcement. The Civil Code was designed to address the needs of a rapidly changing economy, offering clear and consistent rules that could support business development, investor confidence, and the protection of individual rights.

Despite this progress, the development of contract law in Mongolia continues to be influenced by internal and external factors. Integrating international legal norms and best practices is an ongoing process, as Mongolia seeks to contribute its legal framework with global standards while retaining its legal traditions. As such, the development of contract law in Mongolia reflects its domestic legal culture and aspirations to participate in the worldwide economy through attachment to internationally recognized legal standards and practices.

A clear example of this is the franchise agreement, and there is a growing need to study the regulatory framework for this type of agreement in detail, compare it with the experience of other countries, and thereby improve the regulation of franchise agreements in the Civil Code. On the other hand, as Mongolia continues integrating into the global franchise system, a comprehensive legal and economic analysis is essential to develop the sector's sustainable growth. For instance, the franchise and distribution business has rapidly expanded in Mongolia's economy since the early 2000s. Introducing franchise models has played an essential role in integrating Mongolia into global commercial networks, allowing for the transfer of established business practices.

¹ Teshig Munkh Jargal, *History of Mongolian Civil law*, National University Press, 2006, 180.

² Constitution of Mongolia, Article 5.1, "See," in <https://legalinfo.mn/mn/detail?lawId=367>

Since 2001, the Mongolian market has witnessed significant growth in franchising, with the entry of 38 international franchise brands spanning various industries. These include globally recognized manufacturing brands such as Coca-Cola, which operates through local bottling and distribution partnerships, and business format franchises such as KFC, which exemplify the growing presence of multinational fast-food chains nationwide. Expanding these franchises has diversified Mongolia's business landscape, creating employment opportunities and enhancing competition in multiple sectors.³

Beyond the food and beverage industry, the franchising model has also extended into the real estate sector, offering new opportunities for professionalization and international integration. A notable example is the entry of the global real estate franchise ReMax into the Mongolian market. ReMax, a brand operating in 118 countries, has introduced standardized brokerage services, benchmark pricing mechanisms, and international best practices to Mongolia's real estate industry. Such developments highlight the transformative impact of franchising on local industries, demonstrating its potential to enhance market efficiency and attract investment through globally recognized business models.⁴

Expanding franchising in Mongolia has introduced new business opportunities, facilitating international brand entry and economic growth. However, despite its increasing prevalence, the legal framework governing franchising may remain underdeveloped. The Civil Code of Mongolia, which serves as the primary source of private law, does not provide comprehensive regulations addressing the characteristics of franchise agreements. Key elements such as the distinctive legal definition of a franchise, disclosure obligations, and specific contractual requirements, including the timing and scope of material facts that must be disclosed before the conclusion of a franchise contract, are absent from the current legislative framework. This regulatory gap raises significant legal and practical concerns, as the absence of explicit statutory provisions creates uncertainty for both franchisors and franchisees, potentially undermining the enforceability and stability of franchise relationships.

According to my examination, the lack of detailed franchise-specific regulations in the Civil Code highlights a legal deficiency. It raises research questions about the practical applicability of the existing provisions to franchising arrangements. Without a well-defined legal structure, disputes arising within franchise relationships may not be adequately addressed under the current legal framework, leading to judicial interpretation and enforcement inconsistencies. Such a situation is particularly evident in the limited number of franchise-related disputes adjudicated in Mongolian courts. Notably, between 2020 and 2024, only four cases have been registered and resolved under franchise-related litigation. The small number of cases may indicate several issues: franchise disputes might be resolved through alternative means such as private arbitration or informal negotiations, or, more concerning, franchisees may be reluctant to pursue legal action due to the legal uncertainties surrounding franchise contracts.

³ Bat-Erdene, Odontsetseg (eds.), 2020, Characteristics of successful franchising: A Study of franchise businesses operating, "See," in <http://repository.ufe.edu.mn:8080/xmlui/handle/8524/1933>

⁴ "See," in <https://www.remax.mn/aboutus.aspx>

Additionally, it raises the possibility that some franchise disputes are being adjudicated under broader contract law or commercial law principles rather than being explicitly recognized as franchise-related cases.⁵

Given franchising's increasing significance as a business model in Mongolia, there is probably an urgent need to develop a more comprehensive legal framework to regulate franchise relationships effectively. Amendments to the Civil Code that incorporate essential franchise-specific provisions could enhance legal certainty and protect franchisees from potentially unfair contract terms. As Mongolia continues integrating into the global franchise market, its legal framework must contribute to international best practices.

Hence, this study analyzes the legal regulation of franchise agreements in Mongolia, focusing on its contract law framework. It examines the definition of franchising, key conceptual foundations, and the historical development of the franchise model on a global scale. Additionally, the research explores international legal frameworks, stressing the European Union's regulatory approach. To provide a comparative perspective, the study evaluates the significance of franchise regulation in some jurisdictions representing Civil Law and Common Law traditions.

Research Status

Internationally, Spencer⁶, Buchan⁷, Norton⁸, Perkins⁹ Hesselink¹⁰, Diaz¹¹, Gurnick¹², Bosshardt and Lopus¹³, Shelley and Morton¹⁴, Terry¹⁵, Sahan¹⁶, Florea¹⁷, Zeidman¹⁸, Zimmermann¹⁹,

⁵ "See," in <https://shuukh.mn/cases/1/1>

⁶ Spencer (2013) 25-51.

⁷ Jenny Buchan, *Deconstructing the Franchise as a Legal Entity: Practice and Research in International Franchise Law*, Journal of Marketing Channels, 2014, Volume, 21, 43-158.

⁸ Seth Norton, *An Empirical Look at Franchising as an Organizational Form*, The University of Chicago Press, 1988, Volume 61, 197-218.

⁹ Eric Perkins, Fundamentals of Franchising, *Perkins Law PLC*, 2019, 5.

¹⁰ Martijn Hesselink & Others, Principles of European Law Study Group on a European Civil Code: Commercial Agency, Franchise and Distribution Contracts, European Law Publishers, 2006, 91-143.

¹¹ Odavia Buena Diaz, Franchising in European Contract, Comparison Between the Main Obligations of the Contracting Parties in the Principles of European Law on Commercial Agency, French and Spanish Law, European Legal Studies, Volume 8, 2008, 19-54.

¹² David Gurnick, *The First Franchise*, Franchise Law Journal, 2021, Volume 40, 631-646.

¹³ William Bosshardt, Jane Lopus, *Business in the Middle Ages*, Social Education, 2013, Volume 77, 64-67.

¹⁴ Kevin Shelley, Susan Morton, *Control in Franchising and the Common Law*, Franchise Law Journal, 2000, Volume 19, 119-127.

¹⁵ Andrew Terry, Joseph Huan, *Franchisor liability for franchisee conduct*, Monash University Law Review, 2013, volume 39, 388-410.

¹⁶ Guvercin Sahan, *ICC Model International Franchising Contract as a Source of Lex Mercatoria*, Public and Private International Law Bulletin, 2020, Volume 40, 1403-1432.

¹⁷ Dumitrița Florea, Narcisa Gales, *Franchise Contract in International Trade Law*, European Journal of Law and Public Administration, 2022, Volume 9, 12-22.

¹⁸ Philip Zeidman, *The UNIDROIT Guide to International Master Franchise Arrangements: An Introduction and a Perspective*, 1998, 748-768.

¹⁹ Reinhard Zimmermann, Simon Whittaker, *Good Faith in European Contract Law*, (eds) Cambridge: Cambridge University Press, 2000, 7-26.

Hartkamp²⁰, Kerkovic²¹, Anderman²² and Tajti²³ Abell²⁴, Brekoulakis²⁵, Rowley²⁶, Beyer, and Andrews²⁷, and many other authors have conducted research and published scholarly works on franchising.

Domestically, franchising research is quite limited, except for the study by Bat-Erdene & Odontsetseg²⁸, Dorjpalam²⁹, Buyankhisig³⁰, Mendsaikhan³¹, and Batbayar's contract law works.³²

Their work suggests the need for additional research on the regulation of franchising agreements to reveal significant gaps in understanding the complexities of franchise regulation in Mongolia and its alignment with international standards. However, no existing comprehensive or academic studies have thoroughly examined franchise regulation in Mongolia or compared them with other countries' regulatory arrangements. Therefore, this thesis establishes a foundation for advancing further research.

Research Goals and Objectives

This dissertation aims to compare franchise regulation in Mongolian contract law with the legal features of some other countries where franchising is highly developed and to draw valuable conclusions for further improving franchise contract regulation in the Mongolian Civil Code. Therefore, the following objectives and research methodology are set.

1. To study the definition of a franchise, its main characteristics, types, and categories that distinguish it from other contracts.
2. To compare how franchises' concept, meaning, and scope have changed.
3. To determine the features of Mongolian contract law, including the status of franchise agreements.

²⁰ Arthur Hartkamp, Martijn Hesselink, (eds) *Towards a European Civil Code*, Wolters Kluwer Law & Business, 2011, 110-125.

²¹ Tamara Kerkovic, *The Main Directions in Comparative Franchising Regulations*, European Research Studies, 2010, Volume 13, 103-116.

²² Steven Anderman, *The Interface Between Intellectual Property Rights and Competition Policy*, Cambridge University Press, 2007, 369-375.

²³ Tibor Tajti, *Franchise, and Contract Asymmetry: A Common Trans-Atlantic Agenda*. Loyola of Los Angeles International and Comparative Law Review, 2015, Volume 37, 245-273.

²⁴ Abell (2019) 34-133.

²⁵ Stavros Brekoulakis, Julian Lew and Loukas Mistelis, *The Evolution and Future of International Arbitration*, Kluwer Law, 2016, 321-330.

²⁶ William Rowley, (eds) *Arbitration World. Jurisdictional Comparison*, Reference Press, 2004, 119-124.

²⁷ Andrews Neil, *Arbitration & Mediation*, Intersentia, 2013, 89-94.

²⁸ Bat-Erdene, Odontsetseg, (eds) *Characteristics of Successful Franchising: A Study of Franchise Businesses Operating*, 2020, 17.

²⁹ Hyaraadai Dorjpalam, *Contract Law*, 2016, 81,

³⁰ Buyankhisig, *Law of Obligations*, 2013, Soyombo Printing, 24.

³¹ Tumenjargal Mendsaikhan, *On Standard Terms of Contract*, 2003, 58.

³² Batbayar, *Some Issues of Contract Theory and Practice in Mongolia*, Munkhiin Useg Press, 2012, 69.

4. To conduct an in-depth study of franchise regulations in Mongolian contract law.
5. Examine the international legal framework of franchises and the European Union's franchise regulations.
6. To compare franchise regulations in some countries regarding Civil Law and Common Law legal systems.

Hypotheses

This study is based on the following two hypotheses:

1. The Civil Code of Mongolia regulates franchise agreements in an overly general manner and lacks sufficient legal provisions.
2. Examining comparative franchise regulation and conducting comparative studies can identify this regulatory gap.

To examine these hypotheses, the research first analyzes the nature, scope, and regulatory characteristics of contracts within the Civil Code of Mongolia, assessing how general contract law principles apply to franchise agreements.

Subsequently, an in-depth analysis of Chapter 29 of the Civil Code, which governs franchise contracts, will be conducted. Interviews with some Mongolian contract lawyers will be conducted to validate the research findings.

Finally, the study compares franchise regulations in Civil Law countries such as Germany, France, Italy, and Spain with those in Common Law countries such as Canada, the United States, England, and Australia. This comparison aims to identify best practices and legal reforms that could be adapted to improve Mongolia's franchise regulations.

Methods

The dissertation employs historical, comparative, synthetic, analytical, and sociological research methods. The historical method traces the origins of franchising, the timeframes, and the factors that have influenced its development. Understanding the selected countries in the research provides valuable insights into the existing franchise regulatory environment. The comparative method plays a key role in this study, analyzing the legal frameworks of countries with similar legal systems and examining relevant case law. Research continuously aims to develop legal approaches within Mongolian contract law by identifying best practices in well-developed franchising jurisdictions.

Research Importance

This research holds theoretical significance for developing and refining Mongolian contract law, particularly franchise agreements. It clarifies the distinctions between franchise agreements and other types of contracts, aligning them with the contractual frameworks of countries with well-established franchise regulations. Additionally, the findings contribute to the broader field of legal science by offering insights into improving franchise legislation.

This study is also likely to be helpful as a valuable resource for legal professionals specializing in contract and franchise law, increasing their understanding and support for future legislative amendments.

Structure

The dissertation is structured into an introduction, six chapters, 51 sections, case law summaries, conclusions, an appendix, and a bibliography.

Chapter 1 explores the concept, categories, and types of franchising.

Chapter 2 examines the historical development of franchising.

Chapter 3 analyzes the legal framework of contracts in Mongolia and the status of franchise agreements.

Chapter 4 provides an in-depth study of Mongolian franchise regulations.

Chapter 5 reviews international documents related to franchise regulation.

Chapter 6 presents a comparative analysis of franchise laws across different jurisdictions.

Chapter 1. Franchise Concept, Classification, and Requirements for Franchise Agreements

Part 1. Definition of Franchising

1.1. Terminology

Any term, especially those related to law, should be defined clearly and precisely to eliminate ambiguity and avoid multiple or conflicting interpretations. Precision in terms is vital in contractual relationships, as vague or broadly defined terms may lead to differing understandings.

The word ‘franchise’ originated from the French verb ‘franc,’ which means ‘to be free’ or ‘to grant liberty.’ The term has its roots in the Anglo-French language and was first recorded in English during the 14th century. Franchise /fræntʃaɪz/ carries various meanings, including liberty or resilience against something. In English, it initially meant ‘freedom or immunity from burden or restriction granted to a person or group.’³³ In Mongolian, the term franchise “франчайз” is used directly rather than being translated semantically or considered a legal term.³⁴

Franchises have been understood in various business and legal contexts throughout history, but categorizing them remains challenging. According to Black’s Law Dictionary, a franchise is a special privilege conferred by the government on an individual or corporation.

It also refers to any exemption, privilege, or right granted to an individual or group by a public authority, such as the right to use public property for business purposes or the permission granted by the government to operate. However, such interpretations were not common.³⁵

According to various research findings, no single, definitive definition of franchising exists. Its meaning varies by jurisdiction and the specific application or structure of the franchise arrangement in any given context. However, today, the term “franchise” or “franchising” generally refers to a business model in which an individual or company is granted the right to operate under the name and format of an established business in exchange for fees.³⁶

Franchising refers to various interconnected meanings, including franchisor, franchisee, franchise system, franchise disclosure document, franchise fee and royalty, franchise exclusive territory, non-compete franchise agreement, franchise trademark, master franchise, sub-franchise, and area franchise.³⁷

³³ Christopher Fletcher, *Manhood, Freedom and Nation in Later Medieval England*, Revista de Historia, 2020, Volume 21, 81-111.

³⁴ Sodovsuren Narangerel, Legal Dictionary, National University Press, 1994, 276. “Franchise means Grant”

³⁵ Henry Black, Law Dictionary, West Publishing Co, 1968, 786.

³⁶ Spencer (2013) 25-51.

³⁷ Dennis Foster, The Encyclopedia of Franchises and Franchising, 1989, Facts on File, Inc., 384.

Online dictionaries such as Oxford, Merriam-Webster, Longman, Cambridge, and Collins commonly define the following meanings in franchise terms.

“Franchise”- Contractual relationship in which a franchisor grants a franchisee the right to operate under specific goods and services.³⁸

“Franchisor” - The entity that typically owns the trademark, business model, and operational system, providing rights to franchisees.

“Franchisee” - An individual or organization that purchases the right to operate a franchise using the franchisor’s business and systems.³⁹

“Franchise Agreement” - A legally binding contract that outlines the rights and obligations of franchise partners.⁴⁰

“Franchise Disclosure Document” - A document franchisors provide to prospective franchisees detailing business and financial reports and other essential information.⁴¹

According to the above statements, the term “franchise” is inherently multifaceted, shaped by its historical, linguistic, and legal origins. Its roots signify freedom or immunity and have represented other various concepts. These concepts include granting privileges by public authorities and establishing a specific business model governed by contractual relationships.

While franchising is widely acknowledged in legal and commercial circles as a method for operating under an established brand, no single definition exists due to the diverse interpretations of the term.

This ambiguity in franchising terminology, particularly concerning the roles of the franchisor, franchisee, and franchise agreements, highlights the necessity for precise legal definitions to minimize conflicting interpretations and to establish consistent regulation and enforcement of franchising practices. Moreover, a thorough understanding of franchising terminology may require an interdisciplinary approach incorporating insights from contracts and other laws.

³⁸ <https://www.collinsdictionary.com/us/dictionary/english/franchise/related>

³⁹ <https://dictionary.cambridge.org/dictionary/english/franchisee>

⁴⁰ https://www.ldoceonline.com/dictionary/franchise#google_vignette

⁴¹ <https://www.britannica.com/money/franchise-disclosure-document>

1.2. Theoretical Definitions

The definition of a franchise has inevitably varied depending on its historical background, just as any legal concept updates due to social and economic changes or impacts. As more research is conducted on the legal aspects of franchises, the question arises of how this notion has evolved.

First, the definition of a franchise is primarily shaped by the varied enlargement pathways of the franchise model, which are influenced by industry-specific characteristics and the distinct regulatory frameworks of different legal systems. Such differences complicate efforts to establish a universally accepted definition of franchising in a legal context.

Abell argued that franchising works as a commercial mechanism for re-engineering businesses by allowing them to unlock their intellectual property rights' commercial value and potential in domestic and international markets. His viewpoint emphasizes franchising as a strategic commercial tool that utilizes intellectual property to create scalable business models.

Franchising offers a structured approach, often with reduced risks and costs, by enabling businesses to realize the commercial value of their intellectual property. It allows companies to broaden their presence and create a self-sustaining network that encourages growth and profitability while retaining a level of control. On the other hand, the main terms of a franchise agreement (*Essentialia Negotii*) focus on long-term product exchange.⁴²

As noted by Buchan, franchising originated as a way for manufacturers to efficiently and cost-effectively introduce their products into domestic retail markets. The approach allowed manufacturers to broaden distribution networks without significant investments.

Rather than the manufacturer bearing the costs for staffing and managing new stores, franchisees who invest their capital assume these responsibilities. Furthermore, franchisees often have better insights into local market conditions, consumer preferences, and regulatory requirements, enabling the brand to adapt to different regions quickly.⁴³

Norton explains that franchise agreements are a hybrid form of contract law and often resemble full vertical integration. The franchisor earns revenue from franchisees through initial fees, ongoing royalties, and sometimes marketing contributions. These revenue streams enable the franchisor to profit from the franchisee's success without directly managing operations.

Thus, franchise agreements combine vertical integration with the decision-making of independent entrepreneurs, creating a flexible business model. Franchisors typically provide managerial assistance, such as site selection, training programs, standard operating procedures, design of physical layout, and advertising, to the franchisee, who agrees to operate the business according to the franchisor's stipulations.⁴⁴

⁴² Mark Abell, *The Law and Regulation of Franchising in the EU*, Edward Elgar, 2013, 1.

⁴³ Buchan (2014) 43-158.

⁴⁴ Norton (1988) 198-218.

According to the statements above, the hybrid nature of franchise agreements, combining contract law and vertical integration elements, has facilitated such a business model, and franchising effectively allows businesses to expand their distribution networks.

The Author's Definition

Franchising is a structured commercial arrangement facilitating business expansion by utilizing intellectual property, a standardized business model, and brand recognition through independent operators. As a hybrid contractual form, franchise agreements combine aspects of vertical integration with independent entrepreneurship, promoting enduring partnerships while allowing businesses to scale effectively within a controlled framework.

1.3. Statutory Definitions

A franchise agreement is a legally binding contract that establishes the rights, responsibilities, and obligations of the franchisor and the franchisee in a franchise relationship. Agreement frameworks incorporate mandatory law elements.⁴⁵

The International Franchise Association defines franchising as the distribution of products and services in which the owner of a brand, trademark, trade name, or business system pays royalties and an initial fee. The act of “leasing” a trademark constitutes a franchise and the system that defines the overall relationship and the conditions related to operating the business.⁴⁶

The guide to International Master Franchise Arrangements defines franchises as typically categorized into industrial, distribution, and service franchises.⁴⁷

According to the Principles, Definitions, and Model Rules of European Private Law, a franchise is an agreement to lease intellectual property for a fee, as per the instructions provided by the franchisor, utilizing the business’s reputation, methods, and models.⁴⁸

As outlined in the European Union treaty, franchise agreements, as typically defined, enhance the distribution of goods and/or the provision of services.⁴⁹

The European Code of Ethics defines a franchise as a system for renting and selling goods, services, and technology that involves close collaboration between the legally binding and financially independent business entities that form the contract.⁵⁰

As defined in the US FTC Franchise Rule, a franchise is a license that allows an individual or business to use a trademark, commercial name, or business system in connection with market activities. The franchisor (the entity granting the franchise) typically requires the franchisee (the individual or business receiving the franchise) to operate in a specific way.⁵¹ The Rule also defines a franchise as a “franchise,” “business format franchise,” or “distribution.”⁵²

According to the Canadian Arthur Wishart Act, “Franchise” means an agreement between two or more persons under which the franchisor grants the franchisee the right to operate a business using the franchisor’s trade name or mark, and the franchisee must pay a fee or fees for using such rights.⁵³

⁴⁵ Barbara Katz, Joel Owen, *On the Existence of Franchise Contracts and Some of Their Implications*, International Journal of Industrial Organization, 1992, Volume 10, 567-593.

⁴⁶ “See”, in <https://www.franchise.org/faqs/basics/what-is-a-franchise>

⁴⁷ *Guide to International Master Franchise Arrangements*, UNIDROIT, 2019, 8.

⁴⁸ DCFR, IV.E, Commercial Agency, Franchise, and distributorship, 2009, 1:101

⁴⁹ Commission Regulation, 4087/88 of 1988 on the Application of Article 85 (3) of the Treaty to Categories of Franchise Agreements, (7).

⁵⁰ *The Code of Ethics for Franchising*, The European Franchise Federation, 2023, Article 5.1.

⁵¹ US FTC Franchise Rule, 15 U.S.C. § 41 et seq; 16 CFR Part 436

⁵² John Doroghazi, (eds) *Franchise Law Journal*, Serial articles, 2021, Volume 41, 143-269.

⁵³ Arthur Wishart Act, Canada, 2000, Last Amendment, 2017, Chapter 1.

Australian Competition and Consumer Regulations state that a franchise agreement is a written, oral, or implied contract in which a franchisor grants a franchisee the right to operate a business under a system or marketing plan largely controlled or suggested by the franchisor. The agreement encompasses using the franchisor's trademark, commercial symbol, or marketing strategies, which may be directly owned, licensed, or designated by the franchisor or their associates. The franchisee must pay or agree to pay the franchisor or an associated party an amount that may include an initial capital investment fee, payments for goods or services, a royalty or franchise service fee, or a training fee. However, it excludes payments for goods or services provided on a genuine wholesale basis or the repayment of loans from the franchisor or associates.⁵⁴

Based on the above statements, I emphasize that franchise agreements consistently establish a legally binding framework that outlines the franchisor's and franchisee's rights, obligations, and responsibilities. As defined by international and regional regulations such as the International Franchise Association, the European Union, and the US FTC rules, Franchising involves a contractual relationship and systemized business operation. The legal definitions and frameworks across different regions demonstrate the importance of precision in defining the franchise.

⁵⁴ Competition and Consumer Regulations, Australia, 2024, Chapter 1, Part 2, Section 7.

CASE LAW

Franchise Definition

1. The Honda Atlas Car Pakistan Limited v. Federation of Pakistan

Court: Lahore High Court, Pakistan

Facts of the Case

Honda Atlas Car Pakistan Limited (petitioner) entered a License and Technical Assistance Agreement with Honda Motor Company Japan. Under this agreement, the petitioner was granted a license to assemble, manufacture, and sell automobiles using Honda's patents and trademarks. The petitioner also received technical assistance and know-how necessary for manufacturing Honda vehicles in Pakistan.

Legal Issues

Whether the payments made by the petitioner to Honda Japan under the License and Technical Assistance Agreement constituted consideration for franchise services under the Federal Excise Act of 2005. Whether such payments were subject to federal excise duty.

Court Decision

The Lahore High Court ruled that the License and Technical Assistance Agreement between the parties falls within the scope of a franchise agreement defined under the Federal Excise Act of 2005. As a result, the court held that the payments made by the petitioner to Honda Japan constituted consideration for franchise services and were subject to federal excise duty.

Reasoning

The agreement permitted the petitioner to use Honda's intellectual property, including patents, trademarks, and technical know-how, which aligns with the characteristics of a franchise arrangement. The petitioner operated its business using Honda's branding, maintaining the standards and quality associated with Honda, which indicated a franchising relationship. The court defined a franchise as the right to produce, manufacture, sell, or deal in any business product or service for a fee or consideration, including a technical fee or royalty. Since the agreement granted the petitioner the right to operate under Honda's patents in exchange for payments, it satisfied the legal definition of a franchise agreement under the Federal Excise Act.

Conclusion

The court's interpretation clarified that licensing and technical assistance agreements involving intellectual property and brand standards may be classified as franchise agreements, subject them to excise duties. The case also shows that the court may consider each case's specifics instead of relying solely on a rigid franchise definition.⁵⁵

⁵⁵ The Lahore High Court in Pakistan. [2016 PTD 1328].

2. Rafferty v. Madgwicks

Court: Federal Court of Australia

Facts of the Case

Rafferty entered into a contract with Madgwicks concerning the sale of units. Under the agreement, Madgwicks provided designs and layouts for the units. Rafferty was granted a license to use those designs for construction in exchange for a licensing fee. However, the business collapsed in 2008, and Rafferty filed claims against Madgwicks, arguing that The Rights Agreement was, in fact, a franchise agreement. Firstly, the franchisor did not comply with the Franchise Code of Conduct, entitling Rafferty to a refund of all fees paid. Secondly, pre-contractual misrepresentation occurred, as Madgwicks allegedly made misleading statements to persuade Rafferty to enter the agreement.

Legal Issues

Whether the Rights Agreement qualified as a franchise agreement under the Franchise Code of Conduct. Whether Madgwicks misrepresented the terms of the contract or failed to fulfill obligations, leading to the franchise's termination.

Court Decision

The court ruled in favor of the franchisor (Madgwicks) and upheld the franchise agreement. It found that the agreement met the legal definition of a franchise, as it involved granting rights to conduct business under a specific marketing plan using the franchisor's intellectual property and requiring payments to the franchisor. However, Rafferty failed to prove that Madgwicks' actions constituted a breach or misrepresentation that warranted termination of the agreement.

Reasoning

Definition of a Franchise: The court cited the definition of a franchise agreement, which involves a franchisor granting a franchisee the right to conduct business and use a specific marketing plan or system connected to the franchisor's trademark. The payment of fees by the franchisee to the franchisor. Lack of Sufficient Evidence: Rafferty did not provide adequate evidence that Madgwicks misrepresented the agreement's terms or that the franchisor's actions justified a refund of fees.

Conclusion

The case reinforces the legal framework for franchise agreements, particularly the definition of a franchise and the burden of proof required to establish misrepresentation or non-compliance. The ruling highlights that not all licensing agreements qualify as franchise agreements unless they meet the necessary legal criteria.⁵⁶

⁵⁶ Rafferty v. Madgwicks, [2012] FCAFC 37; 203 FCR 1; 287 ALR 437.

1.4. Economic Definition

Definition of Franchising in Game Theory

Any legal relationship exists between two or more interests: acquiring economic benefits and appropriately limiting them according to society's interests. For instance, Calabresi and Melamed's article reflects how the law regulates the relationship between a profit-driven company and the public interest in being free from air pollution.⁵⁷

Mathewson and Winter's "The Economics of Franchise Contracts" has shown a detailed economic framework for understanding the complexities of franchise agreements.⁵⁸

Indeed, a franchise system operates according to Nash's Equilibrium, which means every franchisee can achieve the desired outcome by not deviating from their initial strategy, allowing the market to be shared. To this end, the franchisor assists the franchisee in launching and managing business activities based on a pre-established platform.⁵⁹

As Deng notes, the primary economic definition that agreement parties and competitors follow when negotiating the terms of a franchise agreement is equilibrium based on game theory. However, the franchise agreement does not signify unilateral acceptance of rigid terms imposed by one party; instead, it reflects mutual recognition of the business format that underpins genuine opportunities for profitability.⁶⁰ Likewise, game theory helps to understand the consequences of the franchise negotiation policy on its strategic structure, which is defined through mutually agreed-upon terms.⁶¹

Chatterjee argued that game theory identifies strategies by modeling the behavior of rational franchising. The theory can be applied to various aspects of franchise business, including pricing policy and competitive interactions between franchisors and franchisees.⁶² It also indicates that franchisees and company-owned outlets simultaneously operate in the same market.⁶³ In this way, game theory strongly connects franchise negotiation strategies to achieve their desired outcomes.⁶⁴

⁵⁷ Calabresi and Melamed (1972) 1089-1128.

⁵⁸ Frank Mathewson, Ralph Winter, *The Economics of Franchise Contracts*, Journal of Law and Economics, 1985, Volume 28, 503-526.

⁵⁹ Nash (1950) 48-49.

⁶⁰ Siyuan Deng, Research on Franchised Store Chain Operation Based on Evolutionary Game Theory, 2021, "See", in <https://www.researchgate.net/publication/352565415>

⁶¹ Avery Katz, *The Strategic Structure of Offer and Acceptance: Game Theory and the Law of Contract Formation*, Michigan Law Review, 1990, Volume 89, 216-293.

⁶² Kalyan Chatterjee, *Game Theory and the Practice of Bargaining*, International Series in Operations Research & Management Science, 2014, Volume 35, 189-206.

⁶³ Coase, (1960) 1-44.

⁶⁴ Kenneth Dau-Schmidt, Eric Rasmusen, *On Game Theory and the Law*, Law & Society Review, 1997, Volume 31, 613-630.

Simultaneously, contract law is a fundamental area for applying game theory, as it involves franchise parties or competitors making decisions based on expectations of one another's responses.⁶⁵

Definition of Franchising in the Coase Theorem

Economic principles define franchising as a legally dominant transaction.⁶⁶ For instance, the relationship between the property owner, or franchisor, and its lessee, or franchisee, is closely tied to protecting the enterprise's rights on the one hand and the parties' obligations regarding tangible and intangible assets on the other.⁶⁷

Early discussions of the Coase theorem were often framed within competitive markets. For example, while franchise agreements may seem to restrict competition, their advantages frequently outweigh the potential drawbacks.⁶⁸ These examples demonstrate how intangible assets can be capitalized and generate profit.⁶⁹ Negotiating costs across various aspects, including trademark usage, is essential in franchising. The foundation of these transactions can be understood through the Coase theorem, which has been extensively referenced in numerous studies on contract law.⁷⁰

According to the study by Hesselink et al., franchises are vertical transactions associated with the Coase theorem, suggesting that such contractual relationships arise from transaction costs.⁷¹ Therefore, the Coase theorem is a natural starting point for the franchise agreement parties to negotiate on full costs and property values.⁷² For instance, a trademark certificate is not money but can be utilized as a franchise contract or investment tool.⁷³ Therefore, the theorem states that if transaction costs are low, legal rights will ultimately be transferred to the party that values them the most.⁷⁴

According to the above statements, Game theory and the Coase theorem provide complementary frameworks for understanding the strategic decisions, transaction costs, and economic incentives that shape mutually beneficial, efficient, and sustainable franchise agreements.

⁶⁵ Eric Rasmussen, Law, and Game Theory, 2006. "See", in <https://rasmusen.org/published/Rasmusen-07-book.lawgames.pdf>

⁶⁶ Coase (1960) 1-44.

⁶⁷ Demuynck (2019) 147-154.

⁶⁸ Torsten Schmidt, *An Analysis of Intrabrand Competition in the Franchise Industry, Review of Industrial Organization*, 1994, Volume 9, 293-310.

⁶⁹ Steven Medema, *The Coase Theorem at Sixty*, *Journal of Economic Literature*, 2020, Volume 58, 1045-1128.

⁷⁰ Giorgos Meramveliotakis, Dimitris Milonakis, *Coasean Theory of Property Rights and Law Revisited: A Critical Inquiry*, *Journal of Science & Society*, 2018, Volume 82, 38-66.

⁷¹ Hesselink & Others (2006) 91-143.

⁷² Merges (1994) 2655-2673.

⁷³ Alanson Minkler, *Why Firms Franchise: A Search Cost Theory*, *Journal of Institutional and Theoretical Economics* 1992, Volume 148, 240-259.

⁷⁴ Steven Medema, "Failure to Appear": The Use of the Coase Theorem in Judicial Opinions, 2023, "See", in <https://www.econstor.eu/bitstream/10419/283923/1/1881358771.pdf>

1.5. Definition of Franchising in Mongolia

The Civil Code of Mongolia defines a franchise agreement as using intangible assets such as a firm's name, goods or services, product designs, and packaging, along with a business management system, planning, communication, and the primary direction for obtaining goods and services.

This legal definition also specifies that the franchisor grants the franchisee a license that it legally owns. In exchange, the franchisee must operate according to the system and cooperation program developed by the franchisor and is obligated to pay an initial fee or royalties.

When defining the main characteristics of a franchise agreement, the above formulation may indicate that it is a license agreement for utilizing intangible assets rather than a business collaboration between the franchisor and the franchisee. Additionally, since the Civil Code of Mongolia does not include broad definitions related to distributor and license agreements, comparing them with the definition of a franchise agreement is impossible.⁷⁵

An unofficial interpretation of the Civil Code issued by the National Research Center for Law of the Country states that the franchisor transfers the franchisee the right to use trademarks, goods and services, know-how, and management systems. In return, the franchisee pays a royalty calculated as a certain percentage of income at regular intervals for utilizing those rights.⁷⁶

Some domestic researchers have proposed theoretical definitions of a franchise; however, these explanations have not elaborated beyond the brief definition in the Civil Code. For example, Doljin states that a franchise is a system for selling goods, works, services, and technologies based on a cooperative agreement established for a specific period between the organization or individual creating the franchise and the one joining the agreement. According to her definition, a franchise is similar to a distributor agreement.⁷⁷

Naranchimeg emphasized that the firm name included in the franchise definition is associated with an exceptional production, service, and trade business concept. As she explained, a franchise trademark is any expression a legal entity or individual involved in production or services uses to differentiate their goods and services from others.⁷⁸

In addition to the brief definitions provided in the Civil Code, there is no other comprehensive definition of master, sub, or area franchising. For example, the Civil Code does not clarify whether the franchisor and franchisee are regarded as individuals or legal entities, leading to confusion.

⁷⁵ Civil Code, MGL, 2002, Section 333.1

⁷⁶ Civil Code Commentary, National Center for Justice, 2011, 402.

⁷⁷ Sodnom Doljin, Private law dictionary, National University Press, 2019, 196. "See" in, file:///C:/Users/namsrai.b/Downloads/khuviyn-erkh-zyn-taylbar-tol-o2v.pdf

⁷⁸ Davaasuren Naranchimeg, Contract Law, Volume 2, 2007, 49. "See" in <https://nli.gov.mn/gariinavlaga/Gereenii%20erh%20zui%202.pdf>.

Part 2. Franchise Category

2.1. Business Format Franchising

Unlike product distribution, which focuses on selling products, business modeling involves creating a structured plan that defines how a franchise will operate, generate revenue, and deliver value to the parties involved in the contract.

The systematic model relies on proven methods, equipment, experience, training, and established accounting systems. The characteristics of business format franchising indicate that once the franchisee accepts the terms set by the franchisor, they must be fulfilled without exception. Therefore, it is impossible to determine the conditions suitable for each franchisee.⁷⁹

The framework for business format franchising involves a structured method of expanding a business to operate under the franchisor's brand, utilizing their established model and support. Concerning the types of franchising agreements, single or multi-unit area development and master franchises can be established. Among these contractual options, for instance, the master franchisee benefits from opening several branches under their ownership and selling the rights to open a franchise in that area to other entrepreneurs.

As examined in the above case study, having a franchise offers many advantages, but to meet the obligations outlined in the contract, the parties must obey strict requirements and guidelines while diligently following established business practices and culture. Master franchise agreements frequently impose special conditions, such as minimum sales targets, mandatory participation in marketing campaigns, and ongoing reporting or audit requirements.

While these obligations can be demanding, they support the franchisee's success and protect the franchisor's brand integrity. Hence, before signing a franchise agreement and investing, the franchisee should decide which franchise classification they will choose from the options.⁸⁰

2.2. Management Franchising

A management franchise is a form of business administration in which the franchisee manages business operations. It includes overseeing staffing, handling payroll, and conducting performance evaluations. Additionally, the franchisee monitors business performance, cost management, and resource allocation strategies. The franchisor often provides consulting services to support the franchisee in maintaining brand consistency. The franchise relationship is structured through a detailed labor agreement clearly defining the franchisor and franchisee's responsibilities.⁸¹

⁷⁹ Gordon Storholm, Eberhard Scheuing, *Ethical Implications of Business Format Franchising*, Journal of Business Ethics, 1994, Volume 13, 181-188.

⁸⁰ William Gillis, Gary Castrogiovanni, *The Franchising Business Model: An Entrepreneurial Growth Alternative*, International Entrepreneurship and Management Journal, 2010, Volume 8, 75-98.

⁸¹ Robert Martin, *Franchising and Risk Management*, The American Economic Review, 1988, Volume 78, 954-968.

2.3. Manufacture Franchising

A manufacturing franchise establishes a factory within the authorized territory per the franchise agreement, provides products developed by the IP, or indirectly communicates with the end user. The franchisor licenses production methods or trade secrets about the manufacturing process. The franchisee sets up a factory or production unit that meets the franchisor's specifications and standards. The franchisor may supply the raw materials or components necessary for production, or the franchisee procures them according to the franchisor's guidelines. Simultaneously, the product trademark franchise sells franchise commodities under commercial names, licenses, sales networks, and marketing strategies.⁸²

2.4. Conversion franchising

A conversion franchise involves transforming a company that operates under a specific license into a franchise of a well-known brand in a given area. Conversion enables the licensee to leverage the brand name, marketing and advertising programs, training systems, and customer service standards to enhance profitability. Industries that commonly employ convertible franchising typically include real estate agents. However, there are some difficulties in converting between a license and a franchise agreement in dispute resolution forums.⁸³

2.5. Investment franchising

Investment franchising involves implementing large-scale projects that require significant investment. In this model, the franchisee hires a management team or delegates operations to achieve a financial return and maintains a more passive role. They provide capital for the business but do not engage in its daily operations. Hence, investment franchises' primary focus is generating a return on their investment while hiring managers to run the business and oversee the financial aspects. The main controversy surrounding this type of franchising is how the parties negotiate the investment agreement within the contractual framework.⁸⁴

2.6. Social Franchising

Several social franchises illustrate how franchising principles are applied to achieve social or public welfare goals rather than purely commercial ones. Social franchising blends business strategies with social objectives to address critical issues like healthcare, education, clean water, energy access, and more.⁸⁵

⁸² Thomas Ehrmann, Gérard Cliquet George Hendrikse and Josef Windsperger, *Governance of Franchising Networks*, Journal of Managerial and Decision Economics, 2013, Volume 34, 117-123.

⁸³ Cori Hodge, Harmen Oppewal and Civilai Leckie, *Determinants of Franchise Conversion: A Franchisee Perspective*, European Journal of Marketing, 2010, Volume 47, 1554-1575.

⁸⁴ Steven Michael, *Investments to Create Bargaining Power: The Case of Franchising*, Strategic Management Journal, 2000, Volume 21, 497-514.

⁸⁵ Lisa Jones-Christensen, Helen Parsons and Jason Fairbourne, *Micro-Franchising as an Employment Incubator*, Journal of Business Research, 2010, Volume, 63, 595-601.

CASE LAW

Franchise Category

1. William Gregory et al. v. Popeye's Famous Fried Chicken and Biscuits, Inc.

Court: United States Court of Appeals for the Sixth Circuit

Facts of the Case

The plaintiffs, William Gregory et al., Popeye's Famous Fried Chicken and Biscuits, Inc. franchisees, alleged that the franchisor failed to uphold its contractual obligations under the franchise agreement. The primary claims included:

Inadequate support- Popeye's did not provide the promised training, marketing support, and operational guidance.

Failure to maintain system-wide standards- Popeye's did not deliver consistency in the business model, negatively impacting franchisees.

Encroachment- Popeye's permitted the establishment of new franchise locations that were too close to existing ones, reducing the profitability of the original franchisees.

Legal Issues

Whether Popeye's failed to provide necessary training, marketing support, and operational guidance as required by the franchise agreement. Whether Popeye's placement of new franchise locations constituted a breach of contract by diminishing the market potential of existing franchisees. Whether Popeye's advertising decisions unfairly disadvantaged the franchisees.

Court Decision

The court ruled in favor of Popeye, holding that the franchisor acted within the scope of the franchise agreement and had discretion over key business decisions. The franchise agreement explicitly granted Popeye's sole discretion over advertising timing, selection, and placement. Since no contractual obligation required prioritization of individual franchisees' markets, dissatisfaction with marketing strategy was not a breach. The agreement allocated broad decision-making authority to the franchisor, meaning franchisees had limited control over strategic choices. The franchisor was not legally obligated to satisfy individual franchisees' preferences as long as it operated within the agreement's framework and in good faith.

Reasoning

Contractual Interpretation: The terms of the franchise agreement vested decision-making power in the franchisor, limiting individual franchisees' ability to challenge strategic decisions.

Franchisor's Business Model Authority: The court emphasized that a franchisor has the right to make system-wide decisions, even if they do not benefit all franchisees equally.

Encroachment Claims: The agreement did not prohibit the establishment of new franchises near existing ones, and Popeye's had contractual discretion over location placements.

Conclusion

The case reinforces the principle that franchisors retain broad discretion in managing system-wide operations, even when individual franchisees perceive certain decisions as unfavorable. It highlights the importance of franchisees understanding the limitations of their rights within business format franchise agreements, particularly regarding advertising, territorial rights, and control.⁸⁶

2. *Salazar v. McDonald's Corp.*

Court: United States Court of Appeals for The Ninth Circuit

Facts of the Case

The plaintiffs, employees of a McDonald's franchise, filed a lawsuit against McDonald's Corporation seeking to hold the franchisor liable as a joint employer for alleged violations of California labor laws, including failure to pay overtime wages and to provide meal and rest breaks as required under state law.

The plaintiffs argued that McDonald's Corporation should be held jointly liable for these violations because it controls the franchisee's operations, particularly in brand standards and operational guidelines.

Legal Issue

Whether McDonald's Corporation could be held liable as a joint employer for the labor law violations of a franchisee under California law.

Court Decision

The court ruled in favor of McDonald's Corporation, finding that McDonald's did not qualify as a joint employer for labor law violations. Specifically, the court concluded that McDonald's provided operational guidelines to confirm brand consistency and quality control, but these guidelines were not focused on employee management.

Franchisors are not automatically deemed joint employers just because they exert some control over franchise operations, primarily if that control is aimed at brand protection and product standards, not employee relations.

The court emphasized that while franchisees must follow specific operational standards set by the franchisor, this does not equate to direct control over the daily employment practices of the franchisee's staff.

⁸⁶ United States Court of Appeals for the Sixth Circuit, 1988. 857 F.2d 1474.

Reasoning:

Franchise Relationship and Control: The court recognized that franchising inherently involves some level of oversight, but McDonald's control was deemed focused on branding, product standards, and maintaining consistency across locations.

No Direct Management Authority: The court determined that McDonald's did not have direct control over the franchisee's employment decisions, such as hiring, firing, or scheduling employees. Therefore, McDonald's was not liable for the franchisee's employment-related violations.

Conclusion

The case reinforced the distinction between franchisor oversight and joint employer liability. It clarified that franchisors are not automatically liable for their franchisees' employment violations unless they have direct control over the franchisees' employment practices. This decision underscored the independence of franchisees in managing their operations and affirmed that brand-related guidelines do not translate into employment management authority.⁸⁷

3. *Distefano (Franchisee) v. Tasty Baking Company (Franchisor)*

Court: Stephanie Gallagher, United States District Judge

Facts of the Case

The plaintiff, Distefano, was a franchisee operating under a manufacturing franchise agreement with Tasty Baking Company, granting him the right to produce and distribute baked goods under the Tasty Baking brand. However, Tasty Baking terminated the franchise agreement, citing the franchisee's failure to meet established quality standards. Distefano contested the termination, arguing that it was unjust and represented a breach of the duty of good faith inherent in franchise relationships.

Legal Issues

Whether the termination of the franchise agreement by Tasty Baking was lawful under the terms of the agreement or if the franchisor violated the duty of good faith by terminating the contract.

Court Decision

The court upheld Tasty Baking's termination of the franchise agreement, ruling that the franchisor acted within its contractual rights. The franchise agreement contained provisions allowing Tasty Baking to terminate the franchisee's relationship if specific standards were unmet.

The court found that Tasty Baking's decision to terminate the franchise was justified because Distefano had failed to comply with the necessary quality standards.

⁸⁷ United States Court of Appeals for The Ninth Circuit, No. 17-15673, 2018. *The Salazar v. McDonald's Corp.*

The court further clarified that while good faith is a general principle in franchise relationships, it does not override the specific contractual terms in this case. Since Tasty Baking complied with the contract's termination provisions, no breach of duty occurred.

Reasoning

Contractual Rights and Compliance: The court emphasized that franchise agreements, mainly manufacturing ones, require attachment to established standards. The franchisor had the right to terminate the contract if these standards were unmet.

Duty of Good Faith: While franchise agreements carry an implicit duty of good faith, the court ruled that this duty does not negate the explicit terms of the contract. Tasty Baking's actions were in line with the agreement's provisions for termination based on performance failure.

Conclusion

The case established the importance of upholding the contractual terms of franchise agreements, especially in manufacturing franchises. It reinforced that franchisors have the right to enforce standards. The decision also underscored the balance between contractual rights and the broader principles of franchise relationships.⁸⁸

4. *Okolish v. Town Money Saver, Inc.*

Court: Ohio Court of Appeals, US

Facts of the Case

The plaintiff, Okolish, was a licensee of Town Money Saver, Inc. (TMS), which transitioned from operating under a licensing system to a franchise model. As part of this transition, TMS presented its existing licensees with new franchise agreements, which included arbitration clauses and other terms.

Okolish signed the new franchise agreement but later contested the arbitration clause's enforceability, asserting that it was procedurally and substantively unconscionable. He claimed that the clause was presented in a "take-it-or-leave-it" manner without room for meaningful negotiation and that the terms were not adequately explained, leaving him at a disadvantage.

Legal Issues

Whether the arbitration clause in the franchise agreement was enforceable given its alleged unconscionability.

Whether TMS's presentation of the franchise agreement created an unfair bargaining position due to the lack of negotiation.

⁸⁸ Stephanie Gallagher, United States District Judge. Memorandum Opinion Civil Sag-22-01493, Distefano, Incorporated, Et Al., Plaintiffs, V. Tasty Baking Company, Defendant, 2024. "See," in <https://casetext.com/case/distefano-inc-v-tasty-baking-co-1>

Court Decision

The Ohio Court of Appeals ruled in favor of Okolish, determining that the arbitration clause in the franchise agreement was unconscionable and, therefore, unenforceable.

The court found that the arbitration clause was presented to Okolish in a “take-it-or-leave-it” manner without any opportunity for negotiation, creating a significant power imbalance between the parties. Additionally, the court ruled that the terms of the agreement were not clearly explained, which further contributed to Okolish’s unfair bargaining position.

Reasoning

Procedural Unconscionability: The court emphasized that the lack of negotiation regarding the arbitration clause made the agreement procedurally unconscionable, as Okolish had no meaningful opportunity to bargain or discuss the terms.

Substantive Unconscionability: The court also considered the substantive fairness of the terms and concluded that the imbalance of power and lack of clarity made the arbitration provision unconscionable.

Conclusion

The case is significant in conversion franchising, particularly regarding the enforceability of arbitration provisions in franchise agreements.

The court’s decision highlights the importance of ensuring fair bargaining practices and clarifying contractual terms in ‘conversion franchise’ relationships. It also underscores the principle that franchisors must not impose unilateral terms that place franchisees in an unfair position, especially during the transition from licensing to franchising.⁸⁹

5. *Benjamin Franklin Franchising v. David Michael Plumbing*

Court: Susan K. Declercq, United States District Judge

Facts of the Case

The plaintiffs (Benjamin Franklin Franchising) filed a lawsuit against the Defendants (David Michael Plumbing) in a dispute concerning Franchisee Claims for Promissory Estoppel and violations of the Michigan Franchise Investment Law (MFIL).

The case arose when the franchisee (David Michael Plumbing) alleged that Benjamin Franklin Franchising made promises during the franchise negotiation process that were not fulfilled after the agreement was signed. The franchisee argued that these unmet promises caused financial harm and that the franchisor violated the MFIL, particularly by failing to meet the disclosure requirements mandated by law.

⁸⁹ Okolish v. Town Money Saver, Inc., 9th Dist. Summit No. 2023-Ohio-2865.

Legal Issues

Whether the franchisor's promises made during negotiations could give rise to a promissory estoppel claim despite the terms of the written franchise agreement.

Whether the franchisor violated the Michigan Franchise Investment Law (MFIL) by failing to provide complete and accurate disclosures required under the statute.

Court Decision

The court ruled in favor of the franchisee, allowing the promissory estoppel claims to proceed. The court found that the franchisor's promises during negotiations were separate from or contradicted the written terms of the franchise agreement.

The court emphasized that while promissory estoppel claims are typically barred when contracts are unambiguous, such claims remain valid if the franchisor's promises are independent of the formal agreement.

Regarding the MFIL violations, the court held that the franchisor's failure to comply with MFIL disclosure obligations could be the basis for harm, mainly if the franchisee was not provided with the material information required to make an informed decision.

The failure to meet MFIL's disclosure requirements was found to potentially harm the franchisee's financial interests.

Reasoning

Promissory Estoppel: The court reasoned that promissory estoppel could apply when a franchisor makes promises not reflected in the formal contract. Since the promises made during negotiations were not included in the written agreement, they were deemed enforceable under promissory estoppel.

Violation of MFIL: The court found that MFIL's disclosure requirements were designed to confirm that franchisees have access to critical information before entering into a franchise agreement. The failure to provide such disclosures could create a presumption of harm, justifying the franchisee's claims.

Conclusion

The case underscores the importance of complying with MFIL regulations, particularly about the disclosure requirements in the Franchise Disclosure Document (FDD).

The decision also highlights the potential for promissory estoppel claims to succeed in franchise disputes when the franchisor's promises conflict with the written terms of the agreement. Franchisors must diligently fulfill their contractual and statutory disclosure duties to avoid legal consequences.

This case also shows the characteristics of an investment franchise agreement, the laws governing it, and the legal requirements of the agreement.⁹⁰

6. Marie Stopes International v. Parivar Seva Sanstha

Court: Delhi High Court, India

Facts of the Case

Marie Stopes International (MSI) (Plaintiff) and Parivar Seva Sanstha (PSS) (Defendant) entered into a partnership to provide reproductive healthcare services in India under the MSI brand. As part of their collaboration, MSI granted PSS the right to use the “Marie Stopes” trademark and associated logos. Initially registered as the “Marie Stopes Society,” the organization was intended to leverage MSI’s global reputation to establish quality healthcare services in India.

In 2003, MSI alleged that PSS applied to register the “Marie Stopes” trademark in India without MSI’s authorization, which MSI claimed was a violation of their original agreement. MSI terminated the trademark license agreement, asserting that the “Marie Stopes” trademark was its intellectual property and that PSS’s actions breached the terms of the licensing agreement.

On the other hand, PSS argued that it had the right to register the trademark under Indian law as a local partner and that MSI had no authority over its registration in India. The case arose when MSI contended that PSS continued to use the “Marie Stopes” name and branding after the termination of the agreement, potentially misleading the public into believing the services were still affiliated with MSI.

Legal Issues

MSI’s termination of the trademark license agreement is lawful and consistent with its terms, including:

Whether PSS had the right to apply for registration of the “Marie Stopes” trademark under Indian law despite the agreement’s terms.

Whether PSSs continued use of the “Marie Stopes” name after the termination of the contract constituted an unlawful use of MSI’s intellectual property.

Court Decision

The Delhi High Court ruled in favor of Marie Stopes International (MSI). The court upheld MSI’s position that Parivar Seva Sanstha (PSS) breached the trademark license agreement when PSS applied for registration of the “Marie Stopes” trademark in India without authorization.

⁹⁰ Benjamin Franklin Franchising v. David Michael Plumbing., Susan K. Declercq United States District Judge 10286-2024, “See”, in <https://casetext.com/case/benjamin-franklin-franchising-spe-llc-v-david-michael-plumbing-inc>.

The court determined that MSI's termination of the agreement was valid, as PSS's actions violated the original contract's terms.

The court also found that PSSs continued use of the "Marie Stopes" branding after the termination was unlawful, as it misled the public and infringed MSI's intellectual property rights. The judgment emphasized the importance of upholding contractual obligations in international partnerships, particularly regarding the use of intellectual property.

Reasoning

Trademark Ownership and Use: The court emphasized that the "Marie Stopes" trademark, along with associated logos, was the intellectual property of Marie Stopes International and that PSS's attempt to register the trademark independently was a breach of the licensing agreement.

Breach of Contract: The termination of the licensing agreement was deemed justified due to PSS's actions in seeking to register the trademark without MSI's authorization, which directly conflicted with the agreement's terms.

Public Deception and Trademark Infringement: The court reasoned that PSSs continued use of the "Marie Stopes" name after the termination of the agreement could confuse the public and create an impression that the services were still affiliated with MSI, constituting trademark infringement.

Conclusion

The case highlights the complexities of trademark rights in international partnerships and the potential conflicts that arise when franchising or licensing agreements are breached. It underscores the importance of clear contractual terms regarding intellectual property and enforcing these rights in local and international contexts. Moreover, the case reflects the challenges faced in social franchising, which balances global standards and local laws.⁹¹

⁹¹ Marie Stopes International v. Parivar Seva Sanstha (2010), The High Court of Delhi, No.4907/2005. "See", in <https://indiankanoon.org/doc/140697993/>

Part 3. Characteristics of Franchise Agreement and General Requirements

3.1. What differentiates franchises from other contracts?

Generally, franchising refers to a market relationship where the franchisor grants the franchisee the right to operate a business using the franchisor's model and systems. However, it is frequently mistaken for licensing, distributorships, or agency agreements, particularly in regions where legal distinctions are unclear. Patent rights and vertical market restraints differentiate franchising from distributor trade and other affiliate business alliances.

Franchising embodies privilege and discount, while the firm's name represents a system with an internationally recognized concept in production and service. Considering both terms, franchising encompasses the overall system and process by which a franchisor grants a franchisee the right to operate a business under its rules and recommendations, which include contextual questions.

A franchise refers to a legal and commercial collaboration between a trademark owner and an individual or company that wishes to use that identity. Franchises are highly regulated to protect franchisees and maintain brand consistency, with specific laws governing disclosure and operational standards.

Other business concepts, like dealerships and distributorships, often involve less regulatory oversight and give the business owner autonomy regarding operations and decision-making. These concepts emphasize commercial agreements and contract law.⁹²

Differences in the legal definition and shared understanding of franchising persist, as evidenced by scholarly works on the subject and comparative contract law studies. Licensing, distributorship, and agency agreements often share elements with franchising, leading to misunderstandings or misclassifications.

However, franchisors and franchisees must follow strict procedures for leasing intellectual property and managing the business. Hence, the above features distinguish franchises from other types of contracts.

For example, Buchan emphasizes that franchising is a hybrid relationship that falls directly under the law. In some respects, franchising encompasses complex relationships often governed by incomplete contracts, which can lead to potential conflicts and challenges.⁹³

Franchising is often characterized as a hybrid linkage because it involves legal and economic elements that draw on various areas of law, including contracts, intellectual property, competition, and consumer protection laws.

⁹² Robert Winsor, *Marketing Under Conditions of Chaos*, Journal of Business Research, 1995, Volume 34, 181-189.

⁹³ Buchan (2014) 143-158.

Unlike a straightforward contract between two parties, a franchise relationship combines licensing, agency, and partnership. Thus, franchising does not represent just one of these categories.⁹⁴ Even though franchises share similarities with exclusive agreements for distributors or agents, they stand out due to the comprehensive nature of their business model.⁹⁵

According to Spencer's article, franchises are similar to license agreements and involve many uncertain issues, such as corporate law and land leases; therefore, they should be subject to specific regulations.⁹⁶

On the other hand, franchising represents a new type of agreement compared to traditional contracts such as sales and leases. Additionally, it incorporates characteristics of exclusive agreements, like those involving business agents and distributors. Such distinction arises from what differentiates a franchise from other neighboring contracts. Although it shares similarities with exclusive agreements for distributors or agents, it stands out due to the comprehensive nature of its business model. However, my research indicates that many lawyers do not fully understand the nature and characteristics of franchise agreements for various reasons, such as ambiguous legal definitions or the inherent complexity of the franchise itself. For instance;

While conducting my research, I discussed franchising and its regulatory challenges with colleagues specializing in contract law in Mongolia. Consequently, the research discussion provided a basis for forming my research assumptions.⁹⁷ Throughout our discussions, we examined various interpretations of what defines a franchise and its characteristics. Interestingly, we had different interpretations of franchising, concluding that franchising is a hybrid contract without a universally agreed-upon definition. Such confusion probably influences its legal practice. For example, according to the Unified Database of Mongolian Court Decisions, few franchise disputes were registered from 2013 to 2023. Also, these disputes were not franchise cases but were related to late payments resulting from lease violations and standard distributor agreements.⁹⁸

⁹⁴ Gillian Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, Stanford Law Review, 1990, Volume 42, 927-992.

⁹⁵ Olufunmilola Dada, Winfred Onyas, *Negotiating Agency in Mitigating Franchisee Failure: A Critical Discourse Analysis*, Journal of Industrial Marketing Management, 2021, Volume 98, 1-16.

⁹⁶ Spencer (2013) 25-51.

⁹⁷ Candidates' Research Interviews with Colleague Lawyers, September 2024, Ulaanbaatar, Mongolia.

⁹⁸ "See", in <https://shuukh.mn/cases/1/1>

3.2. Privileges in the Franchise Agreement

Special requirements make franchises a fascinating subject in contract law and the law of obligations. Contract law governs many special conditions and franchise agreements' general terms and fees. Additionally, a detailed discussion of franchises necessitates distinguishing this type of agreement from others that may seem similar. For instance, the primary goal of a franchise agreement is not merely to rent or use intellectual property.

Unlike licensing and patent agreements, franchise businesses must stick to more stringent regulations. The franchisee follows the established business model and accumulated knowledge, sometimes step-by-step. This results in a highly restricted or pressured business dynamic, leading to dependence on the franchisor. However, it does not involve direct management control, typical commercial agencies. Consequently, most case studies indicate strict indirect control within franchises. However, that is the true nature of the franchise. I learned that other types of intellectual property agreements lack the same level of management and oversight as franchises. For example, the franchisor provides support and supervision in various ways, including product branding, ingredients, advertising, employee training, financial reporting, and profit calculations.⁹⁹

While similar to sales, purchase, and distribution agreements, franchises differ in many respects, including the detailed business structure and tiered royalty or contract payment policies described above. Compared to distributorship agreements, franchises may involve asymmetries in bargaining power. However, the concept of equal rights among contract parties depends on the context of the type of agreement.

In practice, principles of equality differ slightly for franchise contracts, meaning the franchisor may hold a dominant position compared to the franchisee. The dominance usually arises because the contract's objectives cannot be met without the intense supervision and guidance of the franchise license holder. Hence, asymmetry is a key feature of franchise agreements compared to other types of contracts. In other words, the limitations and control imposed by the franchisor are essential for adequately protecting intellectual property rights and verifying the proper functioning of the entire system.¹⁰⁰

Nevertheless, these asymmetric contracts stand apart from the competing categories of adhesion, exploitative, and other harmful contract types.¹⁰¹ Additionally, it means that the franchisor has the legal authority to control the franchisee.¹⁰²

⁹⁹ Rozenn Perrigot, Begoña López-Fernández and Guy Basset, *Conflict-Performance Assumption or Performance-Conflict Assumption: Insights from Franchising*, Journal of Retailing and Consumer Services, 2020, Volume 55, 1-10.

¹⁰⁰ Rosa Lapiedra, Felipe Palau and Isabel Reig, *Managing Asymmetry in Franchise Contracts: Transparency as the Overriding Rule*, Management Decision, 2012, Volume 50, 1488-1499.

¹⁰¹ Tajti (2015) 245-273.

¹⁰² Charles Murry, Peter Newberry, Franchise Contract Regulations and Local Market Structure, Online paper, 2021, 2-26. "See," in <http://fmwww.bc.edu/EC-P/wp991.pdf>

The subject of the franchise contract primarily involves the dominance of intellectual property, including management systems and marketing technology, making it distinct from other asset ownership. A franchise agreement is a legally binding document that includes specific considerations related to the scope and territory of the license, as well as the rigid duration of negotiation and renewal terms.

For example, licensing agreements usually involve the use of trademarks. The licensee pays royalties, but there is often less control over business operations than a franchise. Franchisors exercise considerable supervision to maintain brand consistency, while licensors have limited authority over how licensees use the rights, provided such use complies with the contract terms.¹⁰³

¹⁰³ Dianne Welsh, David Desplaces and Amy Davis, *A Comparison of Retail Franchises, Independent Businesses, and Purchased Existing Independent Business Startups*, A Journal of Marketing Channels, 2011, Volume 18, 3-16.

3.3. Transferring a Franchise Duty or Asset Right

Another defining aspect may be transferring a franchise agreement. Such an arrangement typically involves assigning the agreement's rights and obligations to another party, but it does not necessarily mean selling the business. Sometimes, a transfer might occur through other methods, such as restructuring ownership or passing the company.

For instance, as stated in Australian Competition and Consumer Regulations, a franchisee's request to transfer a franchise agreement must include detailed information to allow the franchisor to make an informed decision. The franchisor, in turn, has the right to request any additional relevant information necessary to evaluate the transfer request. A franchisor's consent for transferring a franchise agreement must be given in writing, clearly stating whether permission is granted and, if so, whether it is subject to specific conditions. The franchisor must not unreasonably withhold or revoke consent, as several legitimate circumstances are outlined where permission may be reasonably withheld or withdrawn. Furthermore, if the franchisor fails to respond within a specified timeframe, consent is assumed to be granted.¹⁰⁴

Trademark usage rights can pass from the original franchisor to the franchisee and a transferee (another party, such as a master franchisor or a new franchisee) if allowed by the contract. A transferee could be another franchisee or an external party acquiring the rights under the original agreement. Such transfers' legal framework depends on contract law and specific franchise regulations. The franchisor often retains veto power over transfers to confirm that the transferee is qualified to maintain system integrity.

As Gárdos noted, interpreting the transfer of contracts as “real transfers” aligns with business practices, where the “contractual position” is regarded as an asset that can be passed on under specific conditions.¹⁰⁵

A franchise contract's duties or assets can be transferred, with the contractual position as its subject. In the context of franchising, the franchisee's rights and obligations within the franchise agreement, which form part of the “contractual position,” can indeed be transferred, subject to the franchisor's consent and the terms of the agreement. Such process is generally governed by the contract's transfer provisions, which allow the franchisee to assign or transfer their duties and assets to another party, subject to certain conditions and approvals.

Indeed, franchise agreements are transferable assets, including tangible (e.g., physical outlets, inventory) and intangible assets (e.g., intellectual property rights, goodwill). Franchisees see franchise agreements as investments with resale value. Conversely, franchisees consider the transfer a right, while franchisors view it as a privilege that requires consent. Both sides reflect the reality of franchising as a commercial system, not merely a legal construct.

¹⁰⁴ Competition and Consumer Regulations, Australia, 2024, Part 3, Division 1. “See,” in <https://treasury.gov.au/sites/default/files/2023-08/c2023-436091cp.pdf>

¹⁰⁵ Gárdos Péter, Questions Relating to the Transfer of Contracts, Thesis, 244.

As Dunn observed, the franchisee's ability to transfer or assign its franchise rights to a third party represents a fundamental aspect of the franchisor-franchisee relationship, serving as one of the franchisor's primary mechanisms for maintaining control over the franchise system. From the franchisee's perspective, the right to transfer or assign these rights is vital, enabling them to sell their business, retire, or pass it on to the next generation.

Property rights often create a natural tension: franchisors seek to maintain substantial control over the transfer process to confirm operational consistency, while franchisees typically desire the flexibility to transfer their rights with less interference.¹⁰⁶

¹⁰⁶ Terrence Dunn, *The Franchisor's Control Over the Transfer of a Franchise*, Franchise Law Journal, 2008, 233-239.

3.4. Franchise and Distributor/License Agreements

In my evaluation, while licenses and franchises share common elements, such as granting rights and financial considerations, the key differences lie in the extent of the business relationship, the level of control and support provided, and the connection to a brand and business model. Understanding these distinctions is essential for businesses when deciding between a licensing arrangement and a franchise model based on their needs and goals.

For instance, the franchisor must disclose numerous documents, such as intellectual property certificates and financial reports, before finalizing the franchise agreement for a fixed term. It is a preliminary assurance that if the franchisee obeys the business model, they can generate a certain income level. In return, they accept the franchisor's dominance and follow the established business model. Such essential features may set a franchise apart from other contractual relationships. However, although contracts share similarities and differences, agreements formally recognizing the franchisor's superiority are rare.

Vertical distribution agreements for market sharing seem similar to new franchise systems like master franchises. Still, they do not encompass a wide range of manufacturing, service, or educational sectors, as with franchises. A distributor agreement is commonly based on trade logistics and value-added costs, while a franchise business emphasizes long-term profit by introducing intellectual property to the market.

As Abell noted, distribution differs from franchising. It involves one party agreeing with another to supply specific goods for resale within the entire or a defined area of the common market. Even so, a franchise is similar to an independent distributor who enjoys significant business operation freedom. In other words, a distributor under the strict control of the supplier and manufacturer starts to resemble a franchise. However, a distributor typically purchases the product and sells it at a value-added price.¹⁰⁷

Distributors understand their local markets and customers and maintain relationships with numerous suppliers and manufacturers. They operate independently and typically do not follow the extensive operational guidelines required of franchisees. Moreover, distributors generally do not use the manufacturer's brand as franchisees do. In short, distributors sell products without replicating the business model.¹⁰⁸

Distributorship management contracts involve one company overseeing another company's business operations. The emphasis is on management services rather than duplicating a business model. The level of operational control is more direct and includes day-to-day management, distinguishing it from the broader oversight seen in franchising. In contrast to other agreements, such as licensing, distribution, or management contracts, franchises entail a more integrated and controlled relationship between the parties.

¹⁰⁷ Abell (2013) 45.

¹⁰⁸ *Guide to International Master Franchise Arrangements*, UNIDROIT, 2019, 8.

According to the Perkins article, three main elements define a franchise as a trademark, a detailed payment scheme, and training and assistance in managing the business. He argued that these features distinctly separate a franchise from other types of contracts, further emphasized by a well-defined hierarchical control system. For example, the US FTC Franchise Rule and its accompanying guidelines illustrate such characteristics.¹⁰⁹ Also, as mentioned in his article, license and distributor agreements are similar to franchise agreements but do not have the same strict controls and systematic assistance.¹¹⁰

Distinguishing the franchise agreement from other agreements is essential to prevent potential legal confusion, save costs, and protect the parties' interests. Therefore, I agree with his conclusion that franchise legislation should not overlap. On the other hand, the parties involved in the contract require a flexible arrangement or an open framework to create their business rules. For instance, issues like agreeing on contract payments and choosing a forum for dispute resolution pertain to the parties' legal rights. However, any country's public laws typically govern intellectual property rights. Therefore, in addition to private law, the parties in the franchise agreement comply with mandatory IP laws.¹¹¹

¹⁰⁹ Franchise Rule 16 C.F.R. Part 436, US, FTC Compliance Guide, 2008, 2-5.

¹¹⁰ Perkins (2019) 5.

¹¹¹ Robert French, *A Public Law Perspective on Intellectual Property*, The Journal of World Intellectual Property, 2014, Volume 17, 61-80.

3.5. Franchise and Intellectual Property Agreements

As Bussert argued, the connections between intellectual property and franchises have deepened and diversified as both issues have devolved. Intellectual property has become a critical component of the franchise model, significantly contributing to franchise systems' identity, success, and legal structure. Since the early days of franchising, intellectual property has been used to brand goods and services and identify their source.¹¹²

Trademarks and commercial names were among the initial forms of intellectual property that distinguished one franchise. Over time, trademarks have become a prominent aspect of franchise systems for establishing brand recognition and consumer trust. Franchisors started to seek legal protection for their trademarks to prevent unauthorized use and to maintain consistency across their network.

Moreover, as franchises were released, the scope of intellectual property within systems expanded to include trade secrets, copyrights, and patents. Franchisors share trade secrets with franchisees, including proprietary methods and business strategies, which are protected through confidentiality agreements.¹¹³

Therefore, Broek and Turner concluded that enforcing franchise trade secrets and confidential information protects a franchise business's value.¹¹⁴

Ultimately, franchising shares specific characteristics with exclusive agreements, such as business agents, distributors, and licensing, especially regarding licensing trademarks or intellectual property. However, it goes beyond simply selling goods or leasing property, encompassing a comprehensive business model, operational guidelines, and ongoing support. Distinctive features include upfront franchise fees, recurring royalties, and the added control and support lacking in typical lease agreements. These nuances collectively define the complexity of modern franchising.

¹¹² Christopher Bussert, *Trademark Law and Franchising*, Franchise Law Journal, 2020, Volume 40, 127-148.

¹¹³ Leyland Pit, Julie Napoli, *Managing the Franchised Brand: The Franchisees' Perspective*, Journal of Brand Management, 2003, Volume 10, 411-420.

¹¹⁴ Mark Vander Broek and Christian Turner, *Protecting and Enforcing Franchise Trade Secrets*, Franchise Law Journal, 2006, Volume 25, 191-197.

3.6. Requirements for Franchise Agreement

General Requirements

A franchise agreement is a legally binding contract that defines the relationship between the franchisor and franchisee by outlining their respective rights, responsibilities, and obligations. Any franchise agreement must identify the involved parties and include details regarding the franchisor's legal status, structure, and relevant information about the franchisee. Under the contract, both parties are appropriately recognized and held accountable. The agreement should clearly define the franchisee's rights, including the permission to operate under the franchisor's brand, utilize proprietary systems, and offer specific products or services. The second main requirement is whether the franchisee is granted an exclusive or non-exclusive territory. It is also necessary to define the franchise contracts's duration, including the start and end dates. Provisions for renewal should be included, specifying the criteria and process for extending the agreement upon expiration. The franchisor assists franchisees by offering initial and ongoing training, providing proprietary products and services, delivering marketing and business development support. At the same time, the franchisee must follow the franchisor's business model and quality standards.¹¹⁵

Special Requirements

Franchise agreements typically outline all financial obligations, including the initial franchise fee, ongoing royalties, usually calculated as a percentage of revenue, and marketing and advertising fees for contributions to the franchisor's marketing fund or local advertising needs. The agreement does cover other operational expenses, such as training, technology, and supply procurement fees. The contract should outline the appropriate use of trademarks, logos, business names, and proprietary processes while restricting unauthorized modifications or usage. It may also include provisions governing the transfer or sale of franchise rights, specifying the conditions under which the franchisor must approve a new franchisee.¹¹⁶ Franchise agreements typically include restrictions on competition to protect brand integrity. For example, non-compete clauses prevent franchisees from participating in competing businesses during and after the contract term. Confidentiality clauses are often included to restrict franchisees from disclosing proprietary business information. A franchise agreement specifies the conditions under which the contract may be terminated, such as non-compliance, financial insolvency, or failure to meet performance standards. It outlines the consequences, including the obligation to stop using the brand and return proprietary materials. Furthermore, the agreement should detail dispute resolution methods, such as mediation or arbitration, along with the governing law and jurisdiction for resolving disputes.¹¹⁷

¹¹⁵ Rubin (1978), 223-233.

¹¹⁶ Antony Dnes, *A Case-Study Analysis of Franchise Contracts* 1993, The University of Chicago Press Journals. Volume 22, 367-393.

¹¹⁷ *Ibid.*, 223-233.

CASE LAW

Franchise Agreement Requirements

1. London Business House v. Pitman Training Limited

Court: The English High Court

Facts of the Case

London Business House (Plaintiff) entered into a franchise agreement with Pitman Training Limited (Defendant) to provide professional training services to the local community. The franchise agreement, however, was terminated after Pitman Training was found to have willfully transferred training materials to third parties, allegedly breaching the confidentiality provision of the agreement.

London Business House contended that Pitman's actions had undermined the exclusive rights granted under the franchise agreement and that this breach justified the termination of the contract. The plaintiff argued that Pitman had violated confidentiality and that its actions adversely affected the exclusivity of the franchise relationship.

Legal Issues

Whether Pitman Training breached the franchise agreement by violating confidentiality and transferring training materials to third parties.

Whether the absence of an explicit confidentiality clause in the agreement impacted the enforceability of London Business House's claims regarding confidentiality.

Whether the contract's entire agreement and non-reliance clauses protected Pitman from allegations of pre-contractual misrepresentations and breach.

Court Decision

The court ruled in favor of Pitman Training Limited, finding that the defendant had not breached the franchise agreement as London Business House alleged. The court found that the agreement did not explicitly govern confidentiality, and thus, Pitman did not violate the contract by transferring training materials. Furthermore, the court held that the franchise agreement's entire agreement and non-reliance clauses protected Pitman Training.

These clauses explicitly stated that the written contract represented the full and final understanding between the parties and that neither party relied on representations outside the contract.

Consequently, London Business House could not bring forward any pre-contractual representations as actionable claims under the agreement.

Reasoning

Confidentiality and Exclusivity: The court determined that Pitman Training could not be held liable for violating confidentiality obligations since the franchise agreement did not include an explicit confidentiality clause. Additionally, the court found that Pitman's actions did not undermine any exclusive rights clearly articulated in the contract.

Entire Agreement and Non-Reliance Clauses: The court upheld the validity of the whole agreement and non-reliance clauses. It reasoned that these clauses clearly stated that the contract was the final and comprehensive agreement between the parties, preventing either side from relying on external representations or claims outside the written terms. Since London Business House could not demonstrate any pre-contractual representations, the court ruled that these clauses protected Pitman Training from liability in this context.

Conclusion

The case highlights the importance of including comprehensive and transparent clauses within franchise agreements, especially concerning confidentiality and exclusivity, to prevent disputes. It also underscores the significance of the entire agreement and non-reliance clauses, which can limit the ability of one party to claim reliance on representations made outside of the formal contract.¹¹⁸

2. *Camp Creek Hospitality, Inc. v. Sheraton Franchise Corp.*

Court: United States Court of Appeals, Eleventh Circuit

Facts

Camp Creek Hospitality, Inc. (Plaintiff), a franchisee of Sheraton Franchise Corp. (Defendant), operated a Sheraton Inn franchise for several years. Sheraton granted a new franchise for the Sheraton Gateway Hotel, located near Atlanta Airport, within the same geographic area.

Camp Creek alleged that the manager of the Gateway Hotel, previously employed by Sheraton, improperly accessed confidential information related to Camp Creek's operations. Camp Creek further contended that the Gateway Hotel misused this information to gain an unfair competitive advantage.

Issue

Sheraton's actions constituted misappropriation of trade secrets and whether the non-compete clause was enforceable in light of the alleged misuse of confidential information.

Held

The court ruled that injunctive relief was appropriate to prevent the Gateway Hotel from further misusing Camp Creek's trade secrets and confidential information.

¹¹⁸ London Business House v. Pitman Training-King's Bench Division, Commercial Court [2023] EWHC 1077.

However, the court dismissed Camp Creek's claim for damages for breach of contract. The court held that Sheraton's termination of the franchise agreement was justified and that Sheraton bore no liability for damages under the circumstances.

Ruling

The court's decision emphasized the importance of clearly defining and protecting trade secrets within franchise agreements. Despite the alleged misuse of confidential information, Sheraton was not liable for damages, and the franchise agreement's termination was upheld as lawful.

Conclusion

The case highlights the need to protect trade secrets and confidential business information in franchise relationships. It reinforces the enforceability of non-compete clauses within the context of franchise agreements.¹¹⁹

Based on the *London Business House v. Pitman Training Limited* and *Camp Creek Hospitality, Inc. v. Sheraton Franchise Corp.* emphasize the importance of clearly defined provisions within franchise agreements, particularly regarding confidentiality, exclusivity, and the protection of trade secrets.

These cases underscore the need for comprehensive contract clauses to prevent disputes and confirm that both parties understand their rights and obligations. The decisions also highlight the enforceability of non-reliance and non-compete clauses, which can limit claims based on representations outside the written agreement and reinforce the importance of protecting confidential information and maintaining fair competition within franchise relationships.

¹¹⁹ *Camp Creek Hospitality Inns Inc. V. Sheraton Franchise Corporation* (1998) United States Court of Appeals, Eleventh Circuit. No. 95-8960.

3.7. General Requirements for Franchise Agreements in Mongolia

According to the regulations on franchise agreements outlined in Chapter 29 of the Civil Code, Sections 333-338, the following general requirements apply to franchise agreements in Mongolia. These include:

The Items of the Franchise Agreement

The company's name, goods or services, trademarks, product designs, packaging, business management system, planning, communications, and primary method of acquiring goods or services are defined as the items or exclusive rights of the franchise agreement. The law also requires that the franchisor grant a license to use intangible assets under a franchise agreement.¹²⁰

Rights and Obligations of The Agreement Parties in the Franchise Agreement

According to the agreement between the parties, the franchisor must protect the cooperation program from third-party interference, constantly improve the program, provide the franchisee with the necessary information or technical assistance, and train the employees.

The franchisee must effectively utilize the rights and property granted under the agreement for their intended purpose, pay the initial and recurring fees specified in the contract, confirm that the transferred rights and property benefit the franchisor, avoid transferring the license and franchise agreement to a third party without consent, include employees in the training outlined in the contract, cover the associated costs, and inform customers and clients that they are using the goods and services marks provided by the franchisor.¹²¹

Franchise Disclosure Requirements

The Civil Code generally requires that parties honestly exchange all necessary information when forming a contract and refrain from disclosing confidential information. However, it does not specify which material facts must be disclosed or the timeframe. Such a requirement is not included in the franchisor's legal obligations section.¹²²

Form And Term of Franchise Agreement

The Civil Code requires a franchise agreement to be in writing. The contract must outline the duration, termination and extension procedures, the parties' obligations, and other key conditions, along with a comprehensive implementation program for the franchisee. The term outlined in the agreement has expired, and the parties may, at the initiative of one of them, extend the contract for a specified or indefinite period until the business relationship is terminated, guided by principles of mutual trust and cooperation.¹²³

¹²⁰ Civil Code, MGL, 2002, Section, 333 "See" in, <https://legalinfo.mn/mn/edtl/16532510240071>

¹²¹ *Ibid*, 334.

¹²² *Ibid*, 334.3.

¹²³ *Ibid*, 335.

Restriction of Competition

The franchisor has the right to prevent the franchisee from competing within a specified territory for up to one year following the termination of the franchise agreement. The franchisor must provide suitable monetary compensation if this restriction significantly negatively impacts the franchisee's primary activities.

Compensation for Damages

The franchisee must reimburse the franchisor for any damages and expenses incurred to fulfill obligations under the franchise agreement and any commitments made under the contract. However, the franchisor does not guarantee or take responsibility for the franchisee's income from the agreement. Furthermore, the Civil Code stipulates that the franchisor is not liable for damages caused to customers due to the franchisee's wrongful actions.¹²⁴

The Civil Code outlines that the general requirements for franchise agreements in Mongolia provide a structured framework for establishing the franchisors' and franchisees' rights and responsibilities. These regulations establish the protection of intellectual property, the provision of necessary support and training by the franchisor, and the franchisee's use of granted rights. However, the Civil Code lacks specific guidelines on franchise disclosure requirements.

¹²⁴ *Ibid*, 338.

Chapter Conclusion

Regarding The Definition of a Franchise

Clarifying a franchise concept is essential to distinguishing franchise agreements from other agreements and classifying them within that context. However, depending on the broad content of this type of agreement, it is easy to confuse it with license, distributorship, and patent agreements, as illustrated by the results of theoretical and case law studies.

On the other hand, some industrial and commercial franchise agreements may be mixed, incorporating both distribution and license agreements, as indicated by the definitions of franchise agreements specified in various legal documents. Therefore, it can be concluded that a detailed system of operations and privileged control are the main characteristics of a franchise agreement.

Mongolia's legal definition of a franchise is mainly similar to those outlined in the legal documents considered in this chapter. Still, it is too brief, and sub-terms such as franchisor, franchisee, and master franchise are not recognized. Moreover, domestic researchers have not thoroughly compared and evaluated its theoretical interpretation.

Regarding the General Requirements of a Franchise Agreement

Franchise agreement requirements can be categorized as general and special. Special contract requirements include protecting intellectual property, establishing specific procedures for advertising and training, disclosing legal and financial documents before signing the agreement, and prohibiting competition in the same business for a certain period following the termination of the contract. These requirements are included in the legal regulations of franchise agreements in Mongolia; however, the study concludes that they are brief and general.

Chapter 2. The Historical Background of Franchising

2.1. Origins of Franchising

The chapter examines the methodology of comparative franchise history, a fundamental topic, as is the concept and scope of franchising. A systematic study of the comparative history of franchises is part of this thesis's methodology.

According to studies by Purvin, Hoffman, and Preble, franchising as a business or legal concept originates from the Middle Ages, when franchises were granted to tax or tithe collectors (Purvin, 1994). Later, in the 1700s, business franchises were used by German brewers to manage the distribution of their products through beer halls (Hoffman & Preble, 1991).¹²⁵

Killion also noted the origins of “franchising” during the Middle Ages, when a sovereign granted a subject the legal right to provide a public service for a fee. This concept was then exported from Europe, dominated by kings and other sovereigns, to the United States, where elected officials governed. In this context, the franchise's origin can be seen as granting exclusive powers related to tax collection, land ownership, and the inheritance of skills.¹²⁶

As mentioned in the previous chapter, franchising terminology may have originated as a public law issue, such as a concession or special privilege conferred by the government. Although my research does not definitively confirm this hypothesis, it is essential to clarify how franchising has evolved.¹²⁷

Though it is impossible to determine when and where the franchise agreement was initially established, whether a social or commercial relationship similar to today's franchising existed is intriguing.

Therefore, I would like to begin this part with a historical investigation of specific knowledge and how any form of exclusive rights may have been transferred to others. This leads to the hypothesis that the relationship with the essence of franchises has likely existed for a long time, irrespective of when this legal arrangement emerged.

While I agree that the legal concept of franchising originated in the Middle Ages, as noted by the researchers mentioned above, I would like to present my assumption by exploring this period further. The logical conclusion that the understanding of a franchise must have existed to some degree before the legal definition prompted me to investigate this.

¹²⁵ Robert Winsor, Defining “Franchising” in Marketing: A Review of The Literature, Loyola Marymount University.

¹²⁶ William Killion, *The History of Franchising*, ABA, 1999, Chapter 1, 5-26.

¹²⁷ Richard Epstein, *The Natural Law Origins of Private and Public Law*, The New York University Journal of Law & Liberty, 2024, Volume 17, 208-293.

The main characteristics of franchising, granting exclusive rights to others, teaching, and passing on intellectual property and know-how may have been established long ago.¹²⁸

As introduced in the research articles of Renger,¹²⁹ Wolf,¹³⁰ Eberle,¹³¹ Watson,¹³² Serritella,¹³³ Mattiacci and Guerriero,¹³⁴ Piers,¹³⁵ exclusive rights and know-how were governed by natural and traditional law in the Greek-Roman era. Supervising specialized knowledge and techniques was common in the earliest civilizations, often facilitated through personal relationships, guilds, and apprenticeship systems. Master educators imparted their skills to students in exchange for labor and loyalty. While not a franchise in the strict sense, this arrangement effectively managed the transfer and utilization of intellectual knowledge and techniques over time.¹³⁶

The heritage of ancient cultures established fundamental principles that influenced subsequent economic thought and development, leading to remarkable inventions and advancements. For instance, in ancient Mesopotamia, particularly in Babylon, there were guilds and workshops where craftspeople and artisans practiced their trades. Skills and techniques were often handed down within these groups, and while not formally leased, the supervised dissemination of specialized abilities served a similar purpose in protecting intellectual contributions. Greek philosophers and scholars charged fees for teaching their knowledge and philosophies, which could be viewed as a form of educational franchise where knowledge was temporarily transferred to students.¹³⁷

On the other hand, authorization has structural and functional similarities with master franchising, especially in delegating authority and local adaptation. Although it differs from modern legal contracts in scope and enforcement mechanisms, the foundational principles of formalized and binding commitments show parallels. For example, in the context of contract law, it likely referenced some form of intermediary or representative relationship.¹³⁸

¹²⁸ Tom Burns, Philippe DeVillé, *Socio-Economics: The Approach of Social Systems Theory in a Forty Year Perspective*, Economics and Sociology, 2017, Volume 10, 11-20.

¹²⁹ Johannes Renger, *Institutional, Communal, and Individual Ownership or Possession of Arable Land in Ancient Mesopotamia*, Chicago-Kent Law Review, 1995, Volume 71, 269-311.

¹³⁰ Hans Julius Wolf, *Commentary: Greek Legal History Its Functions and Potentialities*, Washington University Law Review, 1975, Volume 2, 395-408.

¹³¹ Lisa Pilar Eberle, *The Edicts of the Praetors: Law, Time, and Revolution in Ancient Rome*, Law and History Review, 2023, Volume 42, 1-25.

¹³² Alan Watson, *The Evolution of Law: The Roman System of Contracts*, Law and History Review, 1984, Volume 2, 1-20.

¹³³ James Serritella, *The Code of Canon Law and Civil Law*, The Catholic Lawyer, 1984, Volume 29, 195-206.

¹³⁴ Giuseppe Dari-Mattiacci and Carmine Guerriero, *Law and Culture: A Theory of Comparative Variation in Bona Fide Purchase Rules*, Oxford Journal of Legal Studies, 2015, Volume 35, 543-574.

¹³⁵ Maud Piers, *Good Faith in English Law-Could a Rule Become a Principle*, Tulane European & Civil Law Forum, 2011, Volume 26, 124-169.

¹³⁶ Sarantinoudi Ioannaa, Karamanoli Mariaa, *Information Transfer Through Training in Franchising Enterprises*, Procedia - Social and Behavioral Sciences, 2003, Volume 73, 625-633.

¹³⁷ David Corey, *The Case Against Teaching Virtue for Pay: Socrates and The Sophists*, Journal of History of Political Thought, 2022, Volume 23, 189-210.

¹³⁸ William Mack, *Proxeny and Polis: Institutional Networks in the Ancient Greek World*, Oxford, 2015, 22-89.

Additionally, there is some evidence that the ancient ‘patronage system’ involved wealthy individuals sponsoring artists, writers, and inventors by providing financial support in exchange for the benefits of their creations. It was regarded as a form of hiring, where the patron gained access to the creator’s knowledge during their lifetime. Craftsmen and inventors in Rome sometimes operated under contractual agreements that outlined work terms and inventions’ usage. Artisans were contracted to produce works for specific projects or clients, temporarily transferring their skills and expertise for the duration of the contract.¹³⁹

The contracts, called public contracts or *Societates Publicanorum*, resembled franchise agreements in which the state (franchisor) permitted private entities (franchisees) to operate in specific regions or sectors. Hence, the business system in ancient Rome may have been relevant to franchising in several significant ways, including revenue-sharing arrangements, standardization to confirm quality and efficiency, and local operations with central oversight. While the tasks’ primary focus and specific nature differ, leveraging private initiative for broader organizational goals and sharing economic benefits is common to both the *Publicani* and franchising systems.¹⁴⁰

2.2. Franchise Forms in the Medieval Period

I would begin this section by citing Lafontaine and Blair. They observed that in medieval times, a franchise was a right or privilege granted by a sovereign authority, such as a king, church, or local government. Rulers conferred franchises the right to maintain civil order, collect taxes, and promote activities like building roads, holding fairs, and organizing markets.

Essentially, the sovereign granted an individual or group monopoly rights over a specific activity in a designated location for a limited time. In most instances, a grantee was obligated to pay the sovereign authority in exchange for this right or privilege, typically as a share of the product or profit. The franchise payment was referred to as a ‘royalty,’ a term still used today.¹⁴¹

Perkins stated that in the Middle Ages, a local lord granted others the right to hunt, hold markets and fairs, or participate in other activities on his land.¹⁴²

My presumption aligns with that of Lafontaine, Blair, and Perkins. Therefore, I acknowledge that these public law regimes represented the earliest franchise regulations. The earlier franchise concept involved an administrative licensing process and an effective system for bringing intellectual property to market.

The primary driver of progress in the franchise business stemmed from the lack of capital among intellectual creators and innovators, and it was also linked to product and service models.

¹³⁹ Leo Oppenheim, *Ancient Mesopotamia*, The University of Chicago Press, 1964, 63.

¹⁴⁰ Ulrike Malmendier, *Law and the Finance at the Origin*, *Journal of Economic Literature*, 2009, Volume 47, 1076-1108.

¹⁴¹ Francine Lafontaine, Roger Blair, *The Evolution of Franchising and Franchise Contracts: Evidence from the United States*, *Entrepreneurial Business Law Journal*, 2009, Volume 3, 381-434.

¹⁴² Perkins (2019) 6.

According to various sources, during the feudal era, which lasted from the 9th to the 12th century in Europe, the system relied on land allocation in exchange for service or labor. Lords provided land to vassals, who, in return, owed the lord military service or other forms of labor. Such a relationship can be considered a precursor to franchising, as it involves delegation and reciprocal obligation.¹⁴³

Although there is no evidence to suggest that Roman and English law specifically regulated franchise issues, it can generally be explained by the scope of public and private law at that time.¹⁴⁴

For instance, English common law developed gradually, incorporating established customs while creating new legal principles to meet society's changing needs.¹⁴⁵ Judges and legal scholars had to develop fundamental legal principles, such as property rights and contracts, through case law and judicial interpretation.¹⁴⁶

During the medieval period in Europe, contract law continued to evolve, mainly through merchants' practices. The merchant law *Lex Mercatoria* emerged as a commercial law used by European traders. Its rules and applications were rooted in customs and mutual agreements, significantly contributing to the development of modern contract law. The growth of contract law in England marked a notable milestone in the common law tradition. Additionally, the authorities' decisions were considered as valid as the law.¹⁴⁷

Gurnick emphasized that franchises have their roots in common law as special grants of rights from the sovereign. He concluded that rulers historically granted monopoly rights to individuals or companies to produce or trade specific goods. However, these forms of franchises were quite different from modern franchising models. In medieval and early modern Europe, monarchs often issued charters or licenses to individuals or groups, allowing them to conduct certain businesses, collect taxes, or exploit natural resources. These licenses granted the right to operate in specific territories or engage in particular economic activities, similar to the territorial exclusivity often found in contemporary franchise agreements.

For example, guilds and trade associations functioned as early business organizations in England. Craftsmen and merchants established guilds to regulate trade practices, confirm quality standards, and safeguard their interests.¹⁴⁸

¹⁴³ Robert Emmerson, *Franchising and the Collective Rights of Franchisees*, Vanderbilt Law Review, 1990, Volume 43, 1504-1566.

¹⁴⁴ Frank Schechter, *Popular Law and Common Law in Medieval England*, Columbia Law Review, 1928, Volume 28, 269-299.

¹⁴⁵ Richard Gummere, *The Classical Ancestry of the United States Constitution*, American Quarterly, 1962, Volume 14, 3-18.

¹⁴⁶ Hans Wehberg, *Pacta Sunt Servanda*, The American Journal of International Law, 1959, Volume 53, 775-786.

¹⁴⁷ Johannes Ungerer, *A Bidirectional Anglo-German Comparison of Consideration in Contract Law*, International & Comparative Law Quarterly, 2023, Volume 72, 251-268.

¹⁴⁸ Gurnick (2021) 631-646.

The guilds received charters from the local lord or king, granting them the exclusive right to oversee their trade, set standards, and control prices. These systems demonstrated a collective business model in which members upheld common policies and standards.¹⁴⁹

The Statute of Artificers, enacted in 1563 during Queen Elizabeth I's reign, regulated and oversaw apprenticeships and the activities of craftsmen. The law established a system where master craftsmen could take on apprentices and pass on their skills, creating a hierarchical relationship that resembles a precursor to franchising. Additionally, the development of intellectual property law, particularly the Statute of Monopolies (1624), began to formally recognize and protect exclusive rights, a concept crucial to modern franchising, where trademarks and business models are key assets.¹⁵⁰

Additionally, European monarchs began to issue charters to companies, such as the British East India Company and the Hudson's Bay Company, granting them the authority to trade and govern in certain regions. These charters can be viewed as early forms of franchising, in which the crown (franchisor) provides a charter (franchise agreement) to a company (franchisee) to manage a specified area.¹⁵¹

Buchan's research indicates that the British East India Company operated franchise-oriented. He concluded that the company was primarily a commercial enterprise to generate profits for its investors. As the company's commercial activities expanded, it became a significant economic force in India and England. The decision to advance beyond a 'mere' trading company stemmed not from a grand strategy devised in London but from an 'emergent' strategy that developed locally due to the competitive forces present in India at the time.¹⁵²

The earliest example of a franchise concern is the Hudson's Bay Company, founded in 1670 in Canada. The company operated as a fur trading business under a royal charter granted by King Charles II of England. According to the University of Oxford case studies, the Hudson's Bay Company was one of several joint-stock trading companies, including the British and Dutch East India, the Virginia Company in North America, and the Levant Company in the eastern Mediterranean. These companies were granted quasi-official powers to govern the territories they operated, taking on leading roles during an era of European expansion. New commodities, growing markets, and the constant threats of competition and geopolitical interference influenced their business imperatives.¹⁵³

¹⁴⁹ Allan Durant, Janny Leung, *Language, and Law*, Chapter A2 Historical Development of Legal English, Routledge London and New York, 2016, 8.

¹⁵⁰ Bosshardt (2013) 64-67.

¹⁵¹ Michael Seid, Where It All Began. The Evolution of Franchising, "See", in https://www.franchise-chat.com/resources/where_it_all_began_the_evolution_of_franchising.htm

¹⁵² Bruce Buchan, The East India Company 1749-1800: *The Evolution of a Territorial Strategy and The Changing Role of the Directors*, Journal of Business and Economic History, 1996, Volume 23, 52-61.

¹⁵³ Jason Saldanha, The Hudson's Bay Company: Royal Charters, Rivalries and Luxury Hats in the North American Fur Trade, University of Oxford, 2019, Case Study #10

Consequently, more organized forms of franchising have historical roots, beginning in Britain before making their way to the U.S.¹⁵⁴

2.3. Modern Franchising

During the 18th century, the American economy was primarily agricultural, with commerce mainly taking place through small-scale merchants, craftsmen, and farmers. Business practices similar to franchising were rudimentary and often involved local monopolies or exclusive rights granted by colonial governments. However, franchising transitioned from England to the United States by evolving from early commercial practices and legal frameworks into a more structured and widespread business model. Research sources show that the franchise launched in England expanded significantly to North America due to colonial charters.¹⁵⁵

According to Gurnick's article, judicial opinions and scholarly analysis do not consider the possibility that business franchising may have originated even earlier than the 1800s in North America. However, evidence from historical documents suggests that elements of modern business franchising were present at the onset of British expansion to America.

He concluded that Britain's colonization of the New World resembled, in several ways, an entrepreneurial franchise venture, and all the elements of modern business franchise relationships were present. An integral part of the legislative history in the United States is the mixed regulation of commercial and contract law. Commercial law development in the U.S. began with common law principles inherited from England. English common law was the predominant legal system in the American colonies during the colonial period.

Colonists brought English contract and commercial law principles, which governed trade and commerce. The concept of freedom of contract, which allows parties to freely negotiate their agreements' terms, was a cornerstone of English common law and became integral to American contract law.¹⁵⁶

As European settlers arrived in North America, business relationships related to early franchising began to develop. Merchants and producers established distributorship agreements with individuals in various colonies, enabling local entrepreneurs to distribute and sell goods on behalf of the producers, sharing profits in return. Franchising began to take a more modern shape in the late 19th century. In the United States, trademark and product franchising evolved when the 'Singer' sewing machine company was founded in 1851. Gradually, local municipalities began granting franchises to utility companies for water, gas, and electricity. Thus, the next stage in the evolution of franchising emerged around the turn of the 20th century when oil refinery companies and automobile manufacturers started granting the right to sell their products.¹⁵⁷

¹⁵⁴ Killion (1999) 5-26.

¹⁵⁵ Gurnick (2021) 631-646.

¹⁵⁶ *Ibid.*

¹⁵⁷ Shelley, Morton (2000) 119-127.

The success and growth of franchising in America were fueled by innovative business practices, regulatory advancements, and a diverse cultural landscape that encouraged entrepreneurship. Furthermore, since the late 19th century, the franchise relationship in America has moved into a matter of private law; specifically, a focus on commercial law, and discussions surrounding the promotion of competition and the protection of intellectual property have started to emerge.¹⁵⁸

For example, the Sherman Antitrust Act of 1890 and the Clayton Act of 1914 were enacted to protect competitive practices, which indirectly belong to franchise legal issues. The Sherman Act primarily prohibits contracts, combinations, or conspiracies that restrain trade or commerce. The Clayton Act strengthens the Sherman Act by governing specific practices and aims to prevent anti-competitive behaviors before they can cause significant harm to the market. Additionally, in the United States, the evolution of promissory estoppel during the 20th century provided the doctrine of consideration as a basis for enforcing promises.¹⁵⁹

Consequently, justifiable reliance is a legal principle that can significantly impact franchise contracts. It prevents a party from reneging on an obligation even if a legal contract does not exist, provided certain conditions are satisfied. Thus, U.S. courts began to apply estoppel to hold the franchisor accountable for promises made, even if those promises were not included in the written agreement.¹⁶⁰ Therefore, the private law environment has directly affected the introduction of business models like franchises into the free market.¹⁶¹

Franchise legislation emerged in the mid-20th century in response to this business model's rapid growth and expansion. Specifically, the Lanham Act of 1946 seeks to protect service marks and trade dress, enabling franchisors to maintain control over their brand and prevent unauthorized use. Additionally, the Act allows trademark owners to initiate dilution actions to stop uses that could undermine the distinctiveness of their marks, even in the absence of direct competition or likelihood of confusion, thereby safeguarding the value and reputation of well-known brands.¹⁶²

Based on case studies, the primary driving force behind the growth of franchises in the US was the reform of competition and intellectual property laws. Initially, these laws aimed to regulate the parties' contractual obligations and ethical standards, but over time, they improved into more comprehensive commercial arrangements. For example, since 1950, the franchise model has

¹⁵⁸ Martha Olney, Reviewed Work: *Franchising in America: The Development of a Business Method, 1840-1980* by Thomas S. Dicke, *Journal of the Business History Review*, Volume 67, 1993, 157-159.

¹⁵⁹ Hugh Willis, *Restatement of the Law of Contracts of the American Law Institute*, *Indiana Law Journal*, Volume 7, 1932, 429-436.

¹⁶⁰ Nicole Frazer, *Reassessing the Doctrine of Judicial Estoppel: The Implications of The Judicial Integrity Rationale*, *Virginia Law Review*, 2015, Volume 101, 1501-1543.

¹⁶¹ Isaac Hourwich, *The Evolution of Commercial Law*, *American Bar Association Journal*, 1915, Volume 1, 70-76.

¹⁶² Harry Porter, *The Lanham Act*, *History of Education Journal*, 1951, Volume 3, 1-6.

shifted from a licensing system to a distinct type of agreement in contract law, ushering in an era of franchise business formats.¹⁶³

The absence of legal frameworks regulating franchise agreements has led to a notable increase in disputes related to licenses, compensation, and other essential elements of the franchise relationship. In response to this escalating issue, legislative actions, such as the Automobile Dealers Franchise Act of 1957 and the initial U.S. Federal Trade Commission Franchise Rule enacted in 1978, were established to tackle these challenges.¹⁶⁴

¹⁶³ Nicholas Crafts, *The First Industrial Revolution: A Guided Tour for Growth Economists*, The American Economic Review, 1996, Volume 36, 197-201.

¹⁶⁴ The Federal Automobile Dealer Franchise Act. Public Law 1026, U.S.C.A.; Franchise Rule, US Federal Trade Commission, 16 CFR Part 436, Proposed Section 436.2 (a) (1)

CASE LAW

Early Disputes Related to Franchising

1. *United States v. Standard Oil Co. of New Jersey*

Court: U.S. Supreme Court

Facts of the Case

The U.S. government sued Standard Oil under the Sherman Antitrust Act of 1890, accusing the company of engaging in monopolistic and anti-competitive practices.

The government alleged that Standard Oil utilized exclusive contracts, rebates, and intimidation tactics against competitors to suppress competition and maintain its monopoly.

Legal Issues

Whether Standard Oil Co. of New Jersey engaged in monopolistic practices violating the Sherman Antitrust Act.

Court Decision

In a unanimous decision, the U.S. Supreme Court ruled that Standard Oil violated the Sherman Antitrust Act, explicitly engaging in anti-competitive practices that resulted in an unlawful monopoly in the oil industry. The Court applied the “rule of reason” test, determining that only unreasonable restraints of trade were unlawful under the Sherman Act.

The Court ordered Standard Oil’s dissolution into several smaller, competing companies to restore competitive conditions within the oil industry. The ruling marked a significant application of the Sherman Act to combat monopolistic practices and promote fair competition.

Reasoning

Application of the Sherman Antitrust Act: The Court found that Standard Oil’s practices, including predatory pricing, exclusive contracts, and intimidation, constituted monopolistic behavior that violated the Sherman Act. These actions restricted competition and were deemed to be harmful to free trade.

Rule of Reason: The Court applied the “rule of reason” doctrine, which meant that only unreasonable restraints of trade would be deemed unlawful. The Court concluded that Standard Oil’s actions were unreasonable and thus violated the Sherman Act.

Remedy- Dissolution: The Court ruled that the defendant’s monopoly had to be broken up to restore competition in the oil industry. The company was ordered to dissolve into smaller entities to confirm a competitive market structure.¹⁶⁵

¹⁶⁵ Standard Oil Co. of New Jersey v. United States, 221 U.S. 1 (1911), 221 U.S. 1.

Conclusion

The case is considered relevant to franchising forms, particularly concerning the issue of market competition practices that can arise within franchise networks. Therefore, the Court's ruling emphasized balancing competitive business.¹⁶⁶

2. *Mishawaka Rubber & Woolen Mfg. v. S.S. Kresge*

Court: U.S. Supreme Court

Facts of the Case

Mishawaka Rubber & Woolen Mfg. filed a lawsuit against S.S. Kresge, alleging trademark infringement. The plaintiff, Mishawaka Rubber, owned a unique brand name for its footwear. The defendant, S.S. Kresge, was accused of selling shoes that bore a design strikingly similar to the plaintiff's trademark.

Legal Issues

Whether the defendant's footwear design infringed upon the plaintiff's trademark.

Whether the trademark had acquired secondary meaning, thus identifying the source of the goods through consumer recognition.

Whether the plaintiff could recover damages and profits earned by the defendant from using the trademarked design.

Court Decision

The court ruled in favor of Mishawaka Rubber & Woolen Mfg., holding that the plaintiff's trademark had acquired secondary meaning and that consumer confusion existed. The court determined that the defendant's sale of shoes with a similar design infringed on the plaintiff's trademark rights. The court further held that the plaintiff could recover actual damages and the profits made by the defendant from the infringement.

Reasoning

The court emphasized the importance of secondary meaning in trademark law, which occurs when a design or mark becomes identified with the source of the goods through continuous use. The court also introduced the concept of unjust enrichment, concluding that the defendant's profits from trademark infringement should be disgorged.

The case laid the foundation for principles that would later be codified in the Lanham Act, particularly regarding trademark infringement, the protection of brand identity, and the remedies available to trademark owners.

¹⁶⁶ Douglas Melamed, *Antitrust Law and Its Critics*, Antitrust Law Journal, 2020, Volume 83, 269-292.

Conclusion

The *Mishawaka Rubber & Woolen Mfg. v. S.S. Kresge* case significantly influenced the development of trademark law, particularly the Lanham Act. The court's decision highlighted the role of secondary meaning and consumer confusion in trademark infringement claims. It also established that franchise trademark owners are entitled to recover damages and the profits earned by infringers. The case is particularly relevant to franchise agreements, underscoring the importance of protecting brand identity and trademarks in business operations.

2.4. Legislative Tradition of Contract Law and Franchise Regulation in Mongolia

In early Mongolian society, business relationships were primarily governed by oral agreements and customary norms.¹⁶⁷ While these lacked formal codification, they established the foundational principles of reciprocal obligations in commercial transactions.¹⁶⁸ The Yassa and Khalkh Juram formalized contract-based relationships in trade, resembling early attempts at regulating commercial agreements.¹⁶⁹

These legal traditions highlight Mongolia's long-standing engagement in cross-border trade, similar to modern trade and commerce arrangements in which international and local businesses operate under a structured legal framework.¹⁷⁰

The 1926 Civil Code marked Mongolia's first systematic regulation of private legal relations. However, it was heavily influenced by socialist legal traditions, which emphasized state control over business rather than private commercial freedoms.¹⁷¹ Such lack of private-sector-oriented contract law meant that franchising, which depended on independent business ownership under a structured agreement, had no legal basis for development during this period.¹⁷²

Mongolia's 1992 shift to a market economy prompted it to adopt new Civil Codes in 1994 and 2002, incorporating modern contract principles necessary for private business relationships, including franchising.¹⁷³ The country had no legal regulation of franchise agreements before the 1994 Civil Code included a provision stating that intellectual property may be used on a contractual basis as follows:

“Under an agreement on using intellectual property, the owner or the patent holder may transfer the intellectual property to an interested party for a specific purpose and with remuneration. Unless otherwise provided by law or contract, the relevant provisions of this Law shall apply to the agreement on the use of intellectual property.

The agreement on the use of intellectual property shall be made in writing and, if expressly provided by law, shall be registered with the competent authority.

The subject of the contract for the use of intellectual property shall be a discovery, invention, rational proposal, product design, trademark, and copyrighted work that has been formed, registered, and calculated under the procedure prescribed by law.

¹⁶⁷ Lodon Tudev, *Oral Law*, Soyombo Printing, 2000, 169.

¹⁶⁸ Sodovsuren Narangerel, *Historical Overview of Mongolian Law*, National University Press, 2001, 56.

¹⁶⁹ Roman Pochekaev, *the law of the Mongols as seen by John of Plano Carpini*, *Golden Horde Review*, 2022, Volume 10, 8-31.

¹⁷⁰ Makabe Keliher, *Law in Mongol and Post Mongol World*, *China Review International*, 2017, Volume 23, 108-125.

¹⁷¹ Baasandorj Batbayar & others *History of Mongolian Civil Law*, Mongolian Bar Association Press, 2012, 15.

¹⁷² Teshig MunkhJargal, *History of Mongolian Civil law*, National University Press, 2006, 180.

¹⁷³ Teshig MunkhJargal, *Legal Regulation of Economic Relations*, National University Press, 2004, 47.

The contract for the use of intellectual property shall specify the method, form, amount, scope, and period of use of intellectual property, the rights, obligations, and responsibilities of the parties, and other conditions specified by law. The party that fails to perform or improperly performs its contractual obligations shall be liable by the amount and conditions specified by law or the contract.”¹⁷⁴

Consequently, in 1998, the Parliament of Mongolia approved the Legal Reform Program. Legislative reform was a natural starting point in transforming from a centrally planned economy to a free market, reflecting the broader conceptual policies of business.

Furthermore, the reform created conditions for diversifying legislation, eliminating codification gaps, and developing the private law sector. Since the legal reform has been implemented, private branch laws related to company, competition, and trademark regulations have been separated from the Civil Code.¹⁷⁵

Franchise contracts were officially recognized in 2002 with the adoption of the Civil Code, which classified them as a special contractual obligation involving the transfer of intangible assets. The initial legislative effort to regulate franchise agreements occurred within the broader contract law framework. The franchise law regulations included in the 2002 Civil Code have not been modified.

The current legal framework governing franchising agreements marks a significant improvement over the 1994 law on intellectual property, which initially lacked comprehensive regulations for franchising agreements.

¹⁷⁴ Civil Code of 1994, MGL, Sections 285-289.

¹⁷⁵ Sebastian Astrada, *Exporting the Rule of Law to Mongolia: Post-Socialist Legal and Judicial Reforms*. Denver Journal of International Law and Policy, 2010, Volume 38, 461-524.

Chapter Conclusion

The origin of the franchising system and the traditional regulatory development of franchise agreements are the topics least studied in contract law. Since franchise agreements are mixed and include many contract characteristics, defining their exact historical establishment and expansion is impossible.

Therefore, it may be essential not only to study the legal forms of franchising in contractual and commercial legal relations since earlier times but also to make historical comparisons and speculate on how some aspects of similar to modern franchising, such as the use of intellectual property for business purposes and the granting of special rights or licenses, have already emerged.

Such a study provides specific assumptions about how franchising emerged and developed in ancient Greece, Rome, Europe, and America. For example, while franchising was originally a form of passing on knowledge and skills to the locals and teaching them for a fee, in the Middle Ages, it developed into a special license, a monopoly, and a business model.

Due to social, economic, and legal features, franchising in Mongolia is still in its early stages of development compared to other mature franchise countries. In Mongolia, a franchising legal relationship has been part of intellectual property contracts since 1994 and has been an independent subject of contract law and law of obligations since 2002.

Chapter 3. Mongolia's Contract Law: Features, Regulatory Framework

3.1. The Concept of Contract Law

Definition and Function of Contracts

Mongolia's Civil Code establishes contract law as the foundation of business and economic regulation, validating that contracts are the primary legal mechanism governing interactions among individuals and legal entities. Mongolia's Civil Code defines a contract as a legally binding agreement that establishes, modifies, or terminates rights and obligations between two or more parties.

Mongolian legal doctrine asserts that contracts formalize mutual commitments, requiring written documentation or oral negotiation for legal validity. Such mandatory form validates the enforceability of agreements by transforming negotiations into structured legal instruments that delineate and safeguard each party's rights and obligations.¹⁷⁶

Stages of Contract Formation under Mongolian Civil Law

Under Mongolia's Civil Code, contract formation follows a two-phase process of negotiation and agreement, assuring that contractual obligations are clearly defined and legally binding. The negotiation phase facilitates discussions between parties to establish key terms, including rights, duties, and essential conditions.

The agreement phase formalizes these terms through a contract, which attains full legal enforceability upon negotiating by all parties, confirming mutual commitments and obligations.¹⁷⁷

Franchise Agreements and Legal Formalities

As a specialized subset of contract law, franchise agreements must comply with the same legal formalities required for binding contracts under Mongolia's Civil Code. To be enforceable, these agreements must also comply with procedural requirements, including documentation in writing, mutual consent through signatures, and conformity with legal validity criteria.

By meeting these formalities, franchise agreements establish clear rights and obligations between franchisors and franchisees, providing a structured legal framework that governs their business relationship and minimizes potential disputes.¹⁷⁸

¹⁷⁶ Civil Code of Mongolia, 2002, Chapter 15. Contract Law, Section 189. "See," in <https://legalinfo.mn/mn/edtl/16532510240071>

¹⁷⁷ *Ibid*, 199.

¹⁷⁸ *Ibid*, 195.

Validity Requirements of Contracts

For a contract to be legally valid under Mongolian law, it must satisfy essential elements, including clearly defined subject matter, identification of the contracting parties, specified price and payment terms, delineated rights and obligations, and obedience to statutory legal requirements.

Failure to meet these conditions renders a contract invalid or unenforceable. Specialized agreements, such as master franchise agreements, impose additional requirements, particularly regarding the representation of the primary franchise owner. The contract's validity may be challenged if these conditions are not met. Furthermore, contract law requires compliance with statutory formalities, as failing to follow procedural requirements can void a contract.

As a result, a legally valid contract is considered an enforceable document, transforming negotiated terms into binding obligations that protect each party's rights and responsibilities. Confirming the validity of general and specialized agreements, such as franchise contracts, is regulated to encourage legal certainty and stability in commercial transactions.¹⁷⁹

3.2. Fundamental Characteristics of Contracts

Legal Relationship Formation

Contracts in Mongolian law possess several fundamental characteristics that distinguish them as legally binding instruments. These characteristics govern the creation, execution, and enforceability of contracts, ensuring clarity and mutual benefit for the parties involved. The following outlines the key attributes of contracts as defined under Mongolian law. A contract establishes, modifies, or terminates rights and obligations once the parties have agreed upon its terms and formalized the agreement through signatures. This formalization process marks the creation of a legally recognized relationship, wherein the terms of the contract become enforceable under the law. Upon signature, the parties' mutual obligations are acknowledged and legally binding.

Voluntary Nature

Except those mandated by law, contracts are fundamentally rooted in voluntary agreement, clinching that all parties willingly enter into legally binding commitments based on mutual consent. Such foundational principle safeguards the autonomy of contracting parties, allowing them to negotiate terms that best reflect their interests while maintaining legal enforceability. Additionally, contract provisions may extend benefits to third parties under specified conditions, provided the primary parties explicitly agree upon such terms. The voluntary nature of contract formation reinforces the principle that contractual obligations arise not from coercion but from the deliberate and consensual agreement of those involved.¹⁸⁰

¹⁷⁹ *Ibid*, 199.

¹⁸⁰ *Ibid*, 189.

Principles of Equality and Freedom

Contractual relationships, as defined under Mongolian Civil law, are fundamentally based on mutual equality, freedom of agreement, and fair exchange. These principles show that all parties enter contracts equally, preventing coercion or undue influence.

By maintaining the freedom to negotiate terms, contracts create an environment where the agreement's terms are shaped by mutual consent, promoting fairness and establishing a balance of rights and obligations between the parties. The practical application of these principles exists in the agreement's legitimacy and reinforces the concept of fairness, that each party's interests are adequately protected within the contractual framework.¹⁸¹

Compensation Obligation

Under Mongolian Civil law, a foundational element of contracts is the requirement for compensation between the parties, which upholds the principle of fair dealings. Each party of any agreement is obligated to provide appropriate compensation under the agreed-upon terms so that both parties receive adequate consideration for their respective obligations and the overall performance of the contract. Such compensation requirement not only reinforces the mutuality of the agreement but also guarantees that the value exchanged between the parties is balanced, thereby the contract's enforceability and fairness.¹⁸²

Interdependence of Rights and Obligations

Under Mongolian law, the fulfillment of a contract is contingent upon the interdependence of rights and obligations. The effectiveness of a contract hinges on each party's commitment to its respective obligations.

A contract is only valid and enforceable when both parties obey the specific terms and conditions outlined in the agreement, and one party's performance is directly linked to the performance of the other. This interdependence establishes that the mutuality of the contract is maintained and that both parties are bound by a shared responsibility to uphold the agreed terms. Consequently, the contract's enforceability is strengthened, emphasizing the fundamental principle of reciprocal performance and mutual obligation central to contract legal validity.¹⁸³

Formal Documentation

A contract's legal enforceability under Mongolian law is contingent upon its formal documentation, which includes the agreement's necessity to be in writing, signed, and confirmed according to statutory requirements. Such written form is definitive proof of the parties' mutual intent to be legally bound by the contract and safeguards against future disputes regarding its terms and conditions.

¹⁸¹ Buyanhishig, Special Section of Civil Code: Contract Law, Interpress, 2015, 179.

¹⁸² *Ibid*, 180.

¹⁸³ Batbayar, Some Issues of Contract Theory and Practice in Mongolia, Munkhiin Useg Press, 2012, 17.

Moreover, the requirement for written contracts clearly articulates the parties' obligations and rights. It promotes the reliability and stability of legal relationships in general and specialized agreements, such as those in franchising or commercial contexts. Therefore, written contracts are a basis for enforcing contractual commitments while clarifying mutual understanding and intentions.

Future-Oriented Nature

Under Mongolian Civil law, contracts are primarily future-oriented instruments designed to outline and formalize obligations or events expected to occur within a specified period. The primary purpose of most contracts is to define future actions, establishing a clear framework for both parties' responsibilities and anticipated outcomes. However, certain agreements may also recognize and formalize past transactions, provided they meet the essential legal conditions necessary for recognition, such as proof of the transaction and compliance with formalities.

The future-oriented nature of contracts facilitates the planning and performance of contractual obligations that can be continuously adapted to long-term goals, reflecting a dynamic legal framework that aligns with the parties' expectations. Thus, contracts play a role in projecting future commitments and reconciling past dealings, making them a critical tool in shaping and maintaining economic and business relationships.¹⁸⁴

Legal Capacity Requirement

Under Mongolian Civil law, the validity of a contract is fundamentally contingent upon the legal capacity of the parties involved, establishing that an agreement entered into by a party lacking legal capacity is inherently unenforceable.

As a core principle of contract law, it is a legal capacity that all parties can fully comprehend the implications of their actions, thereby safeguarding the integrity and intent of the contractual relationship. Without this essential capacity, any agreement made is void, as it undermines the foundations of informed consent and voluntary participation.

Therefore, legal capacity is vital for establishing that contracts are entered into knowledgeably and responsibly and that the parties can fulfill their obligations under the terms of the agreement without undue influence or lack of understanding. Legal capacity, thus, is a component of contract enforceability, that contractual commitments are formed based on clear and rational judgment.

In a franchise agreement, legal capacity regarding an entity refers to the ability of the business entity (such as a corporation, limited liability company, or partnership) to legally enter into and be bound by the terms of the agreement. The person or individuals signing the agreement on behalf of the entity must have the legal authority to bind the entity.¹⁸⁵

¹⁸⁴ Commentary on the Civil Code, Chapter One, 2022, Articles 189-194.

¹⁸⁵ *Ibid.*

3.3. Classification and Types of Contracts

Types of Contracts in Mongolian Civil Law

In Mongolian civil law, various types and classifications of contracts, each characterized by distinct elements and purposes, establish a framework for understanding the legal relationships between parties. While these concepts function independently, they are interdependent and often influence the nature and execution of one another, affecting how the contract is structured, performed, and enforced. The validity and enforceability of any contract within this system depend on properly fulfilling statutory requirements, ensuring that the agreement's terms are consistent with the law.

Mongolian civil law recognizes two primary types of contracts: oral and written, both legally valid. However, certain agreements, particularly those involving significant rights and obligations, such as franchise agreements, must be documented in writing to confirm clarity, accountability, and enforceability. Legal scholars emphasize that understanding these forms in depth is essential, as failing to the necessary formalities may undermine a contract's enforceability, leading to potential disputes or challenges to its validity. Consequently, the specific manner in which a contract is executed plays a role in its legal strength, compliance with statutory norms, and protection of the parties' rights.¹⁸⁶

Classification of Contracts

The theoretical development of contract law in Mongolia has led to classifications based on various criteria, identifying the standard requirements and essential elements for different types of contracts. These classifications clarify contract types and play a crucial role in defining the legal regulations and terms governing each category of contract.

Among the primary classifications recognized by Mongolian legal scholars are Main Contracts and Preliminary Contracts. Central Contracts establish the rights and obligations of the parties involved as soon as the contract is concluded. Once formalized, these contracts create binding commitments that require immediate fulfillment from both parties.

An illustrative example of a Main Contract is the franchise agreement, where the franchisor transfers the right to use its trademark to the franchisee. In return, the franchisee agrees to pay a fee to the franchisor and follow other stipulated terms.

The intellectual property rights in such an agreement remain active throughout the contract's execution, binding both parties to their mutual obligations. This classification underscores the importance of contractual commitments in shaping legal and commercial relationships, particularly in specialized areas like franchising, where the exchange of rights and obligations is specific and ongoing.¹⁸⁷

¹⁸⁶ *Ibid*, 195-196.

¹⁸⁷ Tumenjargal Mendsaikhan, *Contract Law*, 2021, Admon Press, 158.

3.4. Contract Conclusion and Requirements

The Process of Contract Conclusion

In civil law, a contract is not merely an exchange of promises but a set of rules and procedures that the parties must follow. Once the parties reach a mutual agreement, the contract is formalized and must follow legal requirements to be legally effective. The steps involved in contract conclusion can vary depending on the nature of the obligation. For example, long-term business contracts such as franchise agreements are finalized through a multi-stage process that involves thorough negotiation and formal documentation.

Section 195 of the Civil Code of Mongolia outlines the procedure for concluding a contract, which includes the following stages: Exchange of Offer, Negotiation, and Agreement on Contract Terms, and Implementation of the Agreement-which involves formal approval or entry into force after documenting and certifying the agreement. During the negotiation phase, the process is characterized by the exchange of contract proposals, acceptance of terms, and responses to those offers.¹⁸⁸

Offer and Acceptance

Chapter 15 of the Civil Code governs contract formation in Mongolian Civil law. The chapter establishes the general principles of contractual relationships. Section 189 affirms that parties can enter into contracts within the legal framework and agree upon their terms. It allows them to structure their legal relationship according to mutual interests, provided they comply with statutory requirements. A central concept in forming a contract is the offer, defined as a declaration of intent made by one party to another or a specific group of individuals. For the offer to be legally valid, it must include either the contract's essential terms or a method for determining them.

The offer may lack the necessary elements for a valid contract if key terms are omitted. Once an offer is made, the offering party cannot unilaterally withdraw it during the period specified by law, ensuring that the offeree has a reasonable time to accept or reject the proposal. The offeror must agree to the terms specified in the offer, and the offeree must respond within the time frame provided, or else the offer may expire.¹⁸⁹

Essential Elements of Contract Formation

Under Section 196 of the Civil Code, contracts involving the transfer of property must include the essential terms and the actual transfer of the property for the contract to be legally valid. For instance, in contracts like franchise agreements, where intellectual property and business models are transferred, the parties must agree on key terms, and the actual transfer must also be formalized through written documentation.

¹⁸⁸ Commentary on the Civil Code, Chapter One, 2022, Sections 195-196.

¹⁸⁹ *Ibid*, 189.

Written Contract and Formal Acceptance

For specific contracts, including franchise agreements, formal written documentation is required for the contract to be legally binding. These contracts are considered enforceable only after they have been executed and signed by the parties or when the offeree indicates acceptance of the offer in a manner prescribed by law or mutual agreement. Such a requirement may be particularly significant in franchise agreements, where the franchisor transfers intellectual property, business models, and operational guidelines to the franchisee. By mandating written acceptance, Mongolian contract law states that such agreements are legally enforceable, protecting the interests of both the franchisor and the franchisee.¹⁹⁰

3.5. Contractual Terms

Proposal and Agreement of Terms

According to Section 195 of the Civil Code, for a contract to be valid, its main terms must either be prescribed by law or mutually determined by the parties involved. These essential terms encompass elements such as the subject matter of the agreement, ownership rights, quantity, size, price, and the procedures for fulfilling obligations, including specific timeframes. The mutual negotiation and detailed agreement on these terms are foundational to the contract's enforceability, as they establish the framework for each party's rights, duties, and performance obligations.

For instance, the formation of a franchise agreement begins with one party offering the use of a franchise item or business model and the other party agreeing to acquire or adopt it, initiating a process of mutual negotiation and agreement on the key terms. Therefore, a franchise agreement's success and legal strength depend not only on the parties' willingness to engage in talks but also on their careful attention to the statutory requirements and the precise articulation of these core terms.

The Main Terms of the Contract

According to Mongolian Civil law, the main terms of a contract are essential for its validity, as they outline the elements that must be addressed to render the agreement legally binding. For example, in a franchise agreement, these terms include the subject matter, specifying the goods, services, or intellectual property involved; ownership, which delineates the parties' rights over the franchise items or intellectual property; quantity and size, detailing the amount and dimensions of the goods or services; price, representing the monetary compensation for the exchange or use of the franchise model; obligations fulfillment procedures, describing how and when each party will fulfill their contractual responsibilities; and the time frame, establishing the duration, deadlines within the agreement.

¹⁹⁰ Civil Code, MGL, 2002, Chapter 15. Contract law. Sections 189-205. "See" in <https://legalinfo.mn/mn/edtl/16532510240071>

Such terms will vary based on the specific type of franchise agreement, such as product, business format, or master franchise, and the contract reflects the nature of the relationship and the parties' expectations.

The negotiation and precise articulation of these main terms are fundamental to the contract's enforceability, ensuring clarity and protection for all parties involved. Therefore, the legal validity of a franchise agreement under Mongolian law is contingent upon the clear and mutual understanding of these critical elements, which are essential for the agreement's execution and long-term effectiveness.

Negotiated Terms

In Mongolian contract law, agreements and terms reflect a collaborative approach to contract formation, where each aspect of the contract is discussed and customized to fit the parties' circumstances. It is particularly evident in franchise agreements, where the terms often accommodate the franchisor's business model and the franchisee's specific market conditions. Such customization may include variations in the payment structure, territorial rights, and other key terms based on the franchise type.

However, while these terms are personalized to reflect the needs of each franchise agreement, they must still meet the broader legal norms. Therefore, a franchise agreement's legal validity depends on balancing individual customization and compliance with established legal principles.¹⁹¹

Formalizing the Agreement in Writing

Forming a contract, particularly a franchise agreement, becomes legally binding and effective only once the parties have fully understood the main terms and documented them in writing. The written agreement is a formal acknowledgment of mutual consent, providing clarity on the rights and obligations of each party, thus minimizing potential disputes during the execution of the contract.

In the case of franchise agreements, drafting a comprehensive document is that the agreed-upon terms are concise and outlined to facilitate smooth implementation. The written contract must encompass essential provisions such as each party's specific rights and obligations, the procedures for implementing the agreed terms, a defined schedule for fulfilling these obligations, and any additional terms necessary to function the contractual relationship properly.

Therefore, the written contract is not merely a procedural formality but an instrument for establishing a clear, enforceable framework that governs the franchise relationship and safeguards both parties' interests throughout the agreement's term.¹⁹²

¹⁹¹ Hyaraadai Dorjpalam, Contract Law, 2016, 52-55.

¹⁹² *Ibid*, 62-69.

Legal Validity and Compliance

Regarding a franchise agreement to be legally valid and enforceable under Mongolian Civil law, its terms must fully comply with the Civil Code, and no provisions contradict statutory requirements, moral norms, or generally accepted legal obligations. A contract cannot contain terms prohibited by law nor establish rights and duties that contravene legal or ethical standards, as doing so would render the agreement void or unenforceable.

The final contract must comply with the procedural and substantive guidelines outlined in the Civil Code, safeguarding the mutual interests of both the franchisor and the franchisee. Such reinforces the legitimacy of the franchise relationship and legal certainty, preventing disputes arising from unlawful or ambiguous contractual provisions. Consequently, compliance with statutory requirements is not merely a formality but a fundamental necessity for protecting both parties' rights and maintaining the integrity of the franchising framework.¹⁹³

3.6. Requirements for Entering into a Contract

According to Section 42 of the Civil Code, a simple written contract becomes valid when signed by the party expressing intent. In franchising, this principle means that the agreement becomes enforceable once the franchisee formally consents to join the franchise network, accepts the standardized contract terms, and affixes their signature. A franchise agreement must meet legal and contractual requirements to be legally concluded and considered valid under Mongolian Civil law. This means that all terms, rights, and obligations have statutory provisions and the fundamental principles of franchising. The agreement must not contain provisions that contradict the law or undermine the integrity of the franchise business. In certain instances, contractual terms agreed upon by the parties may take precedence over general legal provisions, reinforcing the principle of contractual freedom within legal boundaries. A franchise agreement attains legal validity once the agreed-upon terms, including the rights and obligations of both parties, are fully reflected in the contract draft and both parties sign and approve the document.

3.7. Standard Terms

Standard Terms in Any Contracts

Standard contract terms are pre-determined provisions unilaterally drafted by one party and offered to another, primarily in recurring business relationships, to streamline contractual negotiations and confirm consistency across multiple agreements. These terms are not explicitly defined by law or shaped through judicial interpretation but emerge from industry practice and commercial necessity.

Unlike individually negotiated terms, which reflect the specific agreements of both parties, standard terms are established in advance by the offering party for repeated use in similar contractual arrangements.

¹⁹³ Batbayar, *Some Issues of Contract Theory and Practice in Mongolia*, Munkhiin Useg Press, 2012, 86.

For instance, in franchise agreements, such standardized provisions maintain uniformity within a franchise network while balancing the franchisor's need for consistency with the franchisee's right to fair contractual terms.

The party receiving the offer, especially if it is a business entity, is expected to know and understand these standard terms before agreeing. If the language of the standard terms is unclear or ambiguous, Mongolian contract law mandates that they be interpreted in favor of the receiving party. This legal principle of fairness prevents the imposition of excessively burdensome or unfair contractual obligations. Suppose one party withdraws from the agreement under the provisions of law or the contract itself. In that case, both parties must return any material performance received and any profits gained during the contract's execution.¹⁹⁴

Standard Terms in Franchise Agreements

In the context of franchise agreements, if the Civil Code does not explicitly outline the terms of the contract, it is classified as a standard franchise agreement. Franchise agreements often include standard terms and conditions prepared in advance by the franchisor. These terms serve as model provisions that apply uniformly across multiple franchisees and govern the regular and recurring aspects of the franchisor-franchisee relationship.

A common characteristic of franchise contracts is that franchisors, often possessing more substantial bargaining power, impose their pre-prepared standard terms on franchisees. In some cases, these standard terms may limit the franchisee's rights under the guise of facilitating business operations. It is particularly evident in agreements involving monopoly enterprises, where the franchisor dictates strict contractual conditions with limited room for negotiation.

While standard terms provide consistency and efficiency, they can be challenged if they contradict the principles of good faith and fairness or disproportionately disadvantage the franchisee. Article 201 of the Civil Code of Mongolia safeguards against such scenarios by allowing ambiguous standard terms to be interpreted in favor of the recipient party. Such principles responsible for unclear provisions can reflect the franchisee's reasonable expectations and understanding. Standard terms of a contract, particularly in franchise agreements, exhibit the following defining features:

- The franchisor predetermines the standard terms for consistent and repeated use across multiple franchise agreements.
- If the franchisee accepts the offer without modification, the standard terms become integral to the contract.
- Standard terms must not violate legal provisions governing contract fairness, good faith, and public policy.
- Any provision contradicting statutory requirements may be deemed invalid.

¹⁹⁴ Commentary on the Civil Code, Chapter One, 2022, Sections 200-202.

- Standard terms are incorporated into the primary contract and become enforceable upon the franchisee's acceptance.¹⁹⁵

The franchisee agrees to these terms by signing the contract or engaging in actions that indicate acceptance, such as paying initial franchise fees. Standard terms are publicly available, and contracts based on these terms are concluded under the same conditions for all franchisees. Franchise agreements typically follow a “take-it-or-leave-it” structure, where all franchisees enter the agreement under uniform terms without the ability to negotiate significant modifications.

Pre-established standard terms streamline the contracting process by eliminating the need for lengthy negotiations. However, if any terms are individually negotiated, they no longer fall under standard contract terms. While standard terms facilitate uniformity and efficiency in franchise agreements, they must align with contract fairness principles and good faith obligations. If standard terms impose excessive burdens on the franchisee or create an unfair advantage for the franchisor, they may be subject to legal scrutiny.

In cases where disputes arise regarding ambiguous standard terms, the Civil Code mandates that such provisions be interpreted in favor of the weaker party, typically the franchisee. This legal protection confirms that standard terms do not become instruments of exploitation. Moreover, specific contractual terms, such as non-compete clauses, termination rights, and royalty adjustments, should be explicitly defined to prevent future conflicts. If these terms are unclear, the franchisee may challenge their validity based on the principle of *Contra Proferentem*, which favors the party that did not draft the agreement.¹⁹⁶

3.8. The Invalidity of Standard Terms and Conditions

Article 202 of the Civil Code establishes the legal grounds for the invalidity of standard contract terms, particularly when they violate the principles of mutual trust and fairness or disproportionately disadvantage the accepting party.

For instance, in franchise agreements, standard terms are deemed unenforceable if they impose excessive or indefinite acceptance periods, grant one party unilateral termination rights without justification, allow arbitrary modifications to contractual obligations or payment terms, severely restrict the franchisee's rights, or prevent the franchisee from seeking damages for breaches of duty.

These provisions that franchise contracts uphold fairness and protect weaker parties from exploitative contractual arrangements. Within the framework of Mongolian contract law, standard franchise terms must comply with statutory principles to be legally valid.

¹⁹⁵ Buyankhisig, Law of Obligations, 2013, Soyombo Printing, 24.

¹⁹⁶ Ibid, 36.

Consequently, the enforceability of standard franchise terms depends on their widespread use and compliance with legal standards designed to prevent abuse and maintain a balanced franchisor-franchisee relationship. Section 202 of the Civil Code also states that a distributor agreement for the regular supply and distribution of goods is viewed as being renewed periodically unless one party proposes its termination. Such agreements may include standard terms and conditions permitting abrupt termination. Other provisions regarding the validity of agreements can be found in Section 202 of the Civil Code.¹⁹⁷

3.9. Legal Basis for Withdrawal from a Contract

Contract law grants parties the right to withdraw from a contract under specific conditions. This right must be exercised within a legally or contractually defined period, and the withdrawing party must formally notify the other party. The right to withdraw becomes invalid if a withdrawal is not communicated within the specified timeframe. While general contract law provides flexibility regarding withdrawal, franchise agreements typically impose stricter withdrawal conditions due to their emphasis on long-term business stability and ongoing mutual obligations. For example, franchise relationships involve substantial investments, brand development, and operational commitments, and abrupt withdrawals may be disruptive to both parties.¹⁹⁸

Withdrawal from a contract terminates the legal relationship. It aims to restore both parties to their pre-contractual state, which means the contractual obligations cease to exist from the moment of withdrawal. Neither party can demand performance under the contract moving forward. However, the withdrawal does not retroactively eliminate past obligations or automatically grant the withdrawing party the right to claim damages.¹⁹⁹

The Withdrawal Process Can Take Different Forms:

Unilateral Withdrawal- One party terminates the contract due to specific legal or contractual grounds, such as a material breach by the other party.

Mutual Withdrawal (Rescission)- Both parties agree to terminate the contract when it no longer serves their mutual interests or becomes unprofitable. Even in cases of mutual withdrawal, the law may impose additional obligations, particularly in contracts where significant resources, trademarks, or business formats have been transferred.²⁰⁰

Grounds for Withdrawal in Franchise Agreements

Franchise agreements include long-term obligations between the franchisor and franchisee, making withdrawal a complex legal process. The most common grounds for withdrawal include:

¹⁹⁷ Civil Code of Mongolia, 2002, Chapter 15. Contract Law, Section 202. “See,” in <https://legalinfo.mn/mn/edt/16532510240071>

¹⁹⁸ Batbayar, Some Issues of Contract Theory and Practice in Mongolia, Munkhiin Useg Press, 2012, 69.

¹⁹⁹ Ibid, 72.

²⁰⁰ Hyaraadai Dorjpalam, Contract Law, 2016, 81.

Material Breach of Contract- If one party fails to fulfill key contractual obligations, the other party may withdraw. Examples include:

- A franchisee violating brand standards or failing to meet financial obligations.
- A franchisor failing to provide agreed-upon support or misrepresenting essential business information.

Failure to Perform Obligations- When a party cannot perform essential duties, such as supplying products, maintaining operational guidelines, or upholding exclusivity clauses.

Mutual Agreement- Both parties may jointly decide to withdraw if the franchise arrangement is no longer beneficial or sustainable. This may occur due to economic downturns, changes in market conditions, or the franchise unit's underperformance.

Contractual Provisions- Certain franchise agreements include predefined exit strategies, such as a cooling-off period, early termination clauses, or renewal conditions. These provisions regulate withdrawal rights and financial settlements.

Implications of Withdrawal on Contractual Obligations

Upon withdrawal, some contractual obligations remain unaffected, while others are terminated:

Termination of Future Performance- Once a withdrawal is finalized, neither party can demand further performance of the contract.

Restoration of Pre-Contractual State- Any physical assets, intellectual property rights, or financial gains obtained under the contract must be returned.

No Automatic Right to Compensation- Withdrawal does not automatically entitle the withdrawing party to damages unless otherwise stipulated.

In franchise agreements, this means that upon withdrawal:

The franchisee must return all proprietary materials, trademarks, manuals, and equipment the franchisor provides. Any profits earned through the franchise operation may need to be accounted for and settled. Also, the franchisor may reclaim operational assets and prevent further use of brand elements.²⁰¹

Withdrawal in Multi-Party Contracts

In contracts involving multiple parties, special rules apply to withdrawal:

Collective Withdrawal- If multiple parties are involved, they may jointly withdraw, or one party may initiate the withdrawal on behalf of others.²⁰²

²⁰¹ Author's own: The grounds for withdrawal from a franchise agreement are outlined based on the general grounds for withdrawal in the Civil Code.

²⁰² Tumenjargal Mendsaikhan, On Standard Terms of Contract, 2003, 58.

Impact of a Single Party's Withdrawal- If one party loses the right to withdraw, the remaining parties may also lose this right, depending on the contract's structure.

For example, in a multi-franchise network, if one franchisee in a joint operation withdraws, the remaining franchisees may need to renegotiate their agreements or adjust their obligations accordingly.

3.10. Termination and Amendment of the Contract

Termination of a Contract

Contract termination signifies the formal conclusion of contractual obligations between the parties. This may occur:

- By Mutual Agreement, both parties agree to terminate the contract, return contractual items, and cease obligations to the extent they have been performed.
- By Unilateral Initiative- One party initiates termination due to specific contractual or legal grounds.
- By Court Decision- A court may terminate a contract if legal provisions justify such action upon the request of one or both parties.

For instance, in franchise agreements, termination differs from simple repudiation, as the parties must return contractual items whenever possible. However, financial settlements may be required if restitution is impractical (e.g., intellectual property use, brand recognition, or goodwill). Additionally, if termination results from the contractual breach, the non-breaching party may demand compensation for damages, which the court will assess based on the circumstances and legal provisions.²⁰³

Legal Effects of Contract Termination

Upon termination, several legal consequences follow:

- Obligations Cease Moving Forward- Neither party must fulfill future obligations under the contract.
- Return of Contractual Benefits- If possible, both parties must return items, assets, or rights obtained through the contract.
- Compensation for Breach- If one party is at fault for termination, they may be liable for damages.
- Judicial Oversight: The termination leads to disputes, and courts may intervene to determine liability, damages, or other compensatory measures.

In the context of franchise agreements, termination may require:

- The franchisee will cease using trademarks, branding, and proprietary materials.

²⁰³ Civil Code, MGL, 2002, Section 294. "See" in <https://legalinfo.mn/mn/edtl/16532510240071>

- The franchisor will refund any prepaid fees or investments, depending on the contract terms.
- The parties to settle outstanding financial obligations related to royalties, inventory, or service fees.²⁰⁴

Amendment of a Contract

A contract amendment involves modifying specific terms to reflect changes in the parties' rights, obligations, or operational conditions. Amendments include:

- Addition, deletion, or clarification of contractual provisions.
- Modifying performance terms, such as duration, quantity, or financial obligations.
- Changes in procedural rules governing implementation.²⁰⁵

For example, franchise agreements often require periodic amendments due to changes in market conditions, regulatory updates, or business strategy adjustments. However, key contractual obligations and fundamental conditions typically remain unchanged unless explicitly agreed upon.

Legal Requirements for Contract Amendments

Mutual Agreement Required- Both parties must approve amendments unless the contract grants unilateral modification rights.

Formal Execution- Unless otherwise specified, amendments must be executed and documented like the original contract.

No Retroactive Effect- Amendments do not retroactively alter obligations already performed unless explicitly stated in the contract.²⁰⁶ In franchise agreements, amendments may not retrospectively impose new duties on the franchisee unless expressly agreed upon. Franchisors often retain the right to update operational guidelines, but significant contractual changes (e.g., fees, territory rights) require franchisee consent.

3.11. Interpretation of the Contract

Legal Framework for Contract Interpretation

Article 198 of the Civil Code of Mongolia provides the legal basis for interpreting contracts, mainly when disputes arise due to ambiguity, misrepresentation, or misunderstanding between the parties. When contractual terms are unclear or disputed, courts apply interpretation principles to confirm an objective and legally sound resolution.

²⁰⁴ Author's own: The grounds for termination from a franchise agreement are outlined based on the civil code's general grounds for contract termination. There are no specific regulations in the Civil Code regarding the termination of franchise agreements.

²⁰⁵ Civil Code, MGL, 2002, Section 220. Contract Termination. "See" in <https://legalinfo.mn/mn/edtl/16532510240071>

²⁰⁶ *Ibid*, 294.

Principles of Contract Interpretation

The primary goal of contract interpretation is to clarify the parties' true intentions at the time of contract formation. This process involves analyzing:

- Literal Meaning of Terms- Courts first assess the natural and ordinary meaning of the words used in the contract.
- Overall Contractual Context- The agreement is reviewed to determine how individual clauses align with its purpose.
- Unspecified Conditions- If key elements are not explicitly stated, courts infer reasonable terms based on industry norms and good faith.
- Purpose and Objectives of the Contract- The parties' original intent at signing is crucial in resolving disputes.
- Understanding of the Receiving Party- If a term is ambiguous, it is interpreted in favor of the party receiving the offer, following Section 201 of the Civil Code.²⁰⁷

Resolving Ambiguities in Franchise Agreements

If a franchise agreement contains unclear or conflicting terms, interpretation must comply with the contract's fundamental intent and business objectives. Key factors include:

- Expressed Intentions- The initial negotiations and documented communications between the franchisor and franchisee.
- Economic and Legal Interests- Courts consider what each party sought to achieve through the agreement.
- Eliminating Contradictions- If terms conflict, preference is given to the interpretation that best aligns with the contract's purpose and promotes fairness.

For instance, if a dispute arises over operational guidelines and the franchise agreement does not explicitly define key terms, courts may interpret the contract based on Industry standards and best practices, the reasonable expectations of a franchisee at the time of signing, and the franchisor's obligations under the Civil Code and franchise disclosure requirements.²⁰⁸

²⁰⁷ *Ibid*, 201.

²⁰⁸ Author's own: The grounds for interpreting a franchise agreement are outlined based on the Civil Code's general grounds for contract interpretation.

Chapter Conclusion

Before analyzing the specific regulation of franchise agreements in Mongolia, I examined the general contract law regulations as a foundation for my research. The chapter governing franchise agreements in the Civil Code does not resolve all issues related to such contracts, necessitating the use of other provisions of contract law by reference. Therefore, the general contract law regulations directly connect with the legal framework for franchise agreements.

Mongolian contract law, codified in Chapter 15 of the Civil Code, governs the formation, execution, and enforcement of contractual law obligations. This framework embodies general principles such as good faith and legal certainty, balancing freedom of contract and regulatory intervention. However, despite granting broad discretion in negotiations and performance, the current structure presents gaps, particularly in addressing commercial agreements like franchising.

Examining general contract law provides a crucial understanding of franchise agreement rules. These legal regulations are essential for interpreting, defining, and evaluating the regulatory framework of franchise contracts, which will be explored in more detail in the subsequent chapter of the thesis.

Chapter 4. Specific Regulations for Franchise Agreements under the Civil Code of Mongolia

4.1. Legal Framework of Franchise Agreements

Items of the Franchise Agreements

Franchise agreements are legally recognized contracts governed by Sections 333 to 339 of Chapter 29, Part 2 of the Mongolian Civil Code, which regulates the transfer of tangible and intangible assets.

Section 333 of the Mongolian Civil Code establishes the legal and economic foundation of franchise agreements by defining franchisors' and franchisees' rights and obligations. The primary purpose of the legal framework is to regulate the franchisor's intellectual property licensing to the franchisee, who, in turn, must follow the franchisor's business model and remit specified payments. Section 333 codifies these structural elements and provides the basis for regulating franchise relationships in Mongolia. Under the above framework, a franchisor grants a franchisee a license issued through established procedures to utilize business assets, including:

- Trade names and trademarks;
- Products and services;
- Service marks and product designs;
- Packaging and branding elements;
- Business management systems, operational strategies, and market planning.

According to legal regulation, the franchisee operates under the franchisor's business model and cooperation program and agrees to compensate the franchisor through fees, royalties, or a fixed percentage of revenue.²⁰⁹ However, no comprehensive definition of franchising and categories of franchise system exists in the Civil Code of Mongolia.

Franchise Agreement Parties

A franchise agreement is a contractual relationship between two independent commercial entities: the franchisor, who owns the intellectual property and business model, and the franchisee, who acquires the right to use these assets in exchange for compensation. Such an arrangement establishes the legal and operational framework for franchising, balancing the franchisor's control over brand standards with the franchisee's autonomy in business operations.

Despite operating under the franchisor's brand, the franchisee remains independent, assuming full responsibility for business risks, profits, and losses. The franchisee is legally separate from the franchisor and bears financial and operational liabilities.

²⁰⁹ Civil Code, MGL, 2002, Chapter 29. Section 333. Franchise and Merchandise.
“See” in <https://legalinfo.mn/mn/edtl/16532510240071>

According to the Civil Code, the franchisor is not responsible for damages caused by the franchisee's wrongdoings or business failures. This legal separation is a defining characteristic of franchise agreements, distinguishing them from employment or agency relationships.²¹⁰

The Civil Code does not provide specific regulations on the legal status of franchisors and franchisees or the legal capacity of individuals and legal entities permitted to participate in a franchise system. No directly applicable regulations exist on the status, ownership, and representation of business entities participating in a franchise relationship.

Key Terms of a Franchise Agreement

Section 335.2 of the Mongolian Civil Code mandates that franchise agreements include essential terms such as duration, termination and extension procedures, party obligations, and an implementation plan.

A franchise agreement is structured around key contractual terms, including the rights granted to the franchisee, obligations to maintain brand standards, financial compensations, contract duration, renewal conditions, operational support and training provided by the franchisor, and termination and dispute resolution provisions. These elements collectively define the legal and commercial framework governing the franchisor-franchisee relationship.

A franchise agreement must be executed in writing to be legally valid. Failure to formalize the agreement in writing renders it legally invalid, making it unenforceable in court. The agreement terms must include:

- The duration of the agreement;
- Component for the agreement;
- The rights and obligations of both parties;
- Procedures for termination, extension, and renewal;
- A detailed implementation plan for the franchise.²¹¹

Although standard requirements in a franchise agreement are essential, the mandatory regulations in a given agreement may vary depending on the type of franchise agreement. However, the Civil Code of Mongolia does not have regulations that consider franchise agreement categories, types, and specificities.

Franchise Agreement Must Be in Writing (Section 335.1)

Section 335.1 of the Civil Code mandates that franchise agreements be documented in writing. This specifies contractual obligations and affirms the enforceability of the franchisor-franchisee relationship. In light of this section, it seems necessary to legislate the requirements for a written franchise agreement.

²¹⁰ *Ibid*, 331.1.

²¹¹ Commentary on the Civil Code, Chapter 29, 2022, Sections 333-338.

Duration of Franchise Agreement (Section 336.1)

Section 336.1 of the Civil Code specifies that the duration of a franchise agreement is determined by the franchisor and franchisee's mutual agreement, considering market conditions, demand, and the franchise's strategic and operational requirements.

Section 336 of the Civil Code establishes that the duration of a franchise agreement is determined by mutual agreement, considering the specific nature of the franchise program. For instance, unless otherwise specified, a franchise agreement lasting more than ten years may be terminated by either party after ten years, with one year's notice.²¹²

Contractual Freedom and Extension of Franchise Agreements (Article 336.3)

Even after the contract term has expired, either party may initiate an extension of the franchise agreement, either for a specific or indefinite period, under the same or revised terms, guided by mutual trust and cooperation, until the business relationship is terminated.

The primary goal of the franchisor is to attract franchisees by integrating them into the franchise system. In other words, franchise systems often impose strict contractual terms. Franchise agreements should provide equal protection for franchisees as franchisors, with clearly defined terms.

Therefore, comprehensive franchise regulations may be essential to preventing unfair contract terms and dealings. However, the general regulation in the current Civil Code, "The parties shall be fair to each other," does not yield the desired results.

4.2. Components of Franchise Agreements

According to the commentary of the Civil Code of Mongolia, a franchise agreement is a legal contract of obligations whereby one entrepreneur (franchisor) allows another entrepreneur (franchisee) to use his business cooperation program, typically within a limited territory.

As stated in the above commentary, a franchise agreement is a mixed agreement in terms of content. In other words, it encompasses elements of a sale-purchase agreement, a work contract, and a lease agreement. However, this does not mean that the regulations of these agreements outlined in the Civil Code can be applied to the interpretation of a franchise, as the Civil Code explicitly governs franchises.

A franchise agreement typically includes key components such as the subject matter, protection of the franchisee's rights (including patents and trademarks), territorial exclusivity, the franchisee's general rights, the type of franchise activity, franchise fees, franchisor's control rights, confidentiality clauses, non-competition provisions, penalties, contract duration, and termination conditions.²¹³

²¹² *Ibid*, 336.

²¹³ *Ibid*, Components of the Franchise Agreements.

4.3. Franchisor's Obligations

In reality, the obligations of the franchisor and franchisee, as stipulated in the Civil Code, are limited or briefly regulated without any detailed explanation, such as “the parties must exchange mutually necessary documents,” etc.

Therefore, the author tried to make a comparison of the rights and obligations of the franchisor and franchisee by citing principles or standard regulations from the general requirements of the contract law of Mongolia while analyzing franchise provisions in the Civil Code as follows:

Fundamental Obligations of the Franchisor

Under a franchise agreement, the franchisor is primarily responsible for verifying the franchisee's success by transferring intellectual property and business assets, facilitating mutually beneficial cooperation, and protecting the franchisee's market from third-party competition within the designated operational territory.

The franchisor's ability to restrict market competition is important for encouraging meaningful cooperation. It enables the franchisee to operate without interference from competing franchise units or external entities.²¹⁴

Support and Assistance Obligations

The franchisor must also provide ongoing technical and operational support, which is critical for the franchisee's success. These obligations include:

Developing a Cooperation Program- The franchisor must establish and implement a structured business framework that enables efficient franchise operations.

Technical Assistance- Providing operational support and product development strategies.

Workforce Training- The franchisor must offer initial and ongoing training to encourage the franchisee and its employees to meet brand standards.

Introducing New Products and Services- The franchisor must continuously develop and supply innovative products or services to maintain market relevance and competitiveness.

Franchisor's Obligation for Ongoing Support: Article 334.1.2 establishes the franchisor's duty to provide continuous support to franchisees throughout the agreement, promoting operational stability and long-term franchise success.

Scope of Franchisor Support: The obligation under Article 334.1.2 includes monitoring market trends, analyzing competition, and introducing new products or services to enhance the franchise's competitiveness.

²¹⁴ Civil Code, MGL, 2002, Section 334.

“See,” in <https://legalinfo.mn/mn/edtl/16532510240071>

Article 334.1.5 establishes that the franchisor is responsible for training the franchisee's employees. The franchisor must provide comprehensive education on the franchise system and its operations, ensuring that the franchisee's workforce is adequately prepared to implement the system effectively rather than placing this responsibility on the franchisee.

Active Franchisor Involvement in Franchise Growth: The franchisor's support may extend beyond the initial setup, requiring active engagement in assisting franchisees with market adaptation and business expansion to maintain system-wide sustainability. These obligations stem from the franchisor's duty to support operations and validate that franchisees receive the necessary resources to function effectively.²¹⁵

Duty to Protect Competition

A franchisor has a paramount duty to protect competition by guaranteeing exclusive or semi-exclusive market territories for franchisees. This obligation includes preventing market saturation and internal competition, franchisees maximizing revenue, and strengthening brand loyalty within their designated territories.²¹⁶

Article 337.1 grants franchisors the right to impose a competition prohibition on the franchisee for up to one year following the termination of the franchise agreement. However, a balance must be struck between the franchisor's interests and the franchisee's rights. Moreover, Section 337.2 stipulates that the franchisor must compensate the franchisee for any "serious" damage caused by the non-compete clause, although the definition of "serious" damage is unclear.

Supply Obligations

A franchisor has a fundamental duty to franchisees to acquire the necessary products and materials specified in the agreement. The obligation entails directly supplying branded goods and services, utilizing authorized suppliers, and enforcing exclusive procurement requirements.

Duty of Supervision and Information Disclosure

A franchisor has a supervisory obligation to monitor and enforce compliance with business standards, consistent quality, and operational efficiency across all franchise locations. This duty may include conducting periodic inspections and audits to assess obeying brand guidelines and financial requirements and providing ongoing policy updates.²¹⁷

Information and Knowledge Transfer

The franchisor's obligations for information and knowledge transfer, as outlined in Articles 334.1.3 and 334.1.4, require essential information, comprehensive training, ongoing support, and technical assistance to clinch franchisee competence and success.

²¹⁵ Author's own: Based on Commentary of the Civil Code, Chapter 29, 2022, Sections 333-338.

²¹⁶ This section will be used in conjunction with the Competition Law of Mongolia. Refer to the Law on Competition, MGL, 2010, Section 6.1.

²¹⁷ *Ibid*, 334.1.3.

However, the lack of specificity in the requirements for know-how transfer regulation of the Civil Code of Mongolia creates potential ambiguity, which could lead to uncertainty in franchise relationships.²¹⁸

4.4. Obligations of the Franchisee

Franchisee Obligations under the Franchise Agreement

Section 334.2 outlines franchisee obligations, mandating attachment to operational standards, financial commitments, and franchisor guidelines to maintain consistency and success within the franchise network.

As outlined, section 334.1.1 lacks clarity regarding franchisee protection from competition, particularly regarding territorial exclusivity and the restriction of competing franchises within the same region. The provision implies that franchisors must provide market stability by preventing direct competitors from entering the franchisee's designated area, but the absence of explicit language creates ambiguity in its application.

Hence, franchisees have several duties: following competition directives, participating in training, protecting intellectual property, and reinforcing brand integrity and uniformity across the franchise system.

Financial Obligations

The franchisee is contractually required to provide financial compensation to the franchisor for the right to operate under the established brand. These financial obligations include:

Initial Fee- A one-time payment made at the beginning of the franchise agreement.

User Fee or Royalty Payments- Ongoing payments are made regularly, either as a fixed fee or a percentage of revenue the franchisee generates.

Commissions and Additional Fees- Some agreements may require the franchisee to contribute to advertising, technology support, or other operational expenses. According to section 334.2.2 of the Civil Code of Mongolia, the franchise fee structure varies depending on the agreement, but it is a fundamental requirement for maintaining the franchise relationship.²¹⁹

Insurance and Transferring Agreement

Section 334.2.3 clarifies that the franchisee is not required to take out insurance unless explicitly stipulated in the franchise agreement. The franchisor's discretion determines whether to include insurance obligations and the franchisee is bound only if such provisions are clearly outlined in the contract. Section 334.2.4 emphasizes that the franchisee is prohibited from transferring the franchise agreement or its associated rights to a third party without the franchisor's approval.

²¹⁸ *Ibid*, 334.1.4.

²¹⁹ This section will apply to Mongolia's Tax and Investment Laws. "See also," Law on Investment, MGL, 2013, Section 6.7.

Proper Use of Intellectual Property and Other Assets

A franchisee must strictly use the franchisor's intellectual property, trademarks, and business systems as defined in the franchise agreement, including prohibitions on unauthorized transfers of franchise rights, compliance with trademark and brand use requirements, workforce training, and operational standards to maintain service and product quality.²²⁰

Section 334.2.5 establishes that the franchisee must actively participate in training and other events organized by the franchisor, which are essential for maintaining the franchise system's operational standards. Typically, the franchisee is responsible for covering the associated costs unless otherwise specified in the agreement. The above obligation applies to the franchisee remaining updated on the franchisor's latest practices, innovations, and standards.

Moreover, section 334.2.6 defines the franchisee's responsibility to protect the franchisor's intellectual property rights, including trademarks, licenses, and proprietary business knowledge. While the franchisee is granted exclusive rights to use these intellectual properties within the franchise system, they must have their proper use and protection by the terms of the agreement.

Operational and Procurement Obligations

The franchisee's primary obligation is to operate the business under the franchisor's organized system. This includes following the franchise manual, maintaining consistency in service and product delivery, and adapting to operational updates introduced by the franchisor.

The franchisee must comply with the franchisor's business model and operational guidelines, including franchisor instructions, exclusive procurement requirements, and establishing and operating the business location according to the franchisor's specifications. These obligations establish operational consistency, maintain brand reputation, and deliver a uniform consumer experience across all franchise units.²²¹

Sales and Marketing Responsibilities

The franchisee's primary business objective is to drive sales and promote the brand, which includes actively maximizing sales and market reach, fulfilling minimum purchase or storage requirements, and participating in advertising and marketing campaigns. These obligations confirm the franchisee's active contribution to the success of the franchise network by maintaining strong sales performance and brand visibility.

Section 334.2.1 of the Civil Code governs that the franchisee's core responsibility is to focus on sales, directing their efforts toward selling goods and services within the scope of the franchise agreement.

²²⁰ This section will be applied in conjunction with the Intellectual Property Law of Mongolia. Refer to the Law on Intellectual Property, MGL, 2020, Section 7.

²²¹ This Section will be applied in conjunction with the Law on Consumer Rights. "See also," Law on Consumer rights, MGL, 2003, Section 5.4

The above obligation is supplemented by additional requirements such as minimum purchase obligations, sourcing goods exclusively from the franchisor or authorized suppliers, complying with storage conditions, and engaging in promotional activities.²²²

4.5. Joint Obligations and Compensation for Damages

General Obligations of Both Parties

A franchise agreement is a contractual relationship in which the franchisor and the franchisee assume mutual responsibilities. These include negotiating, drafting, and finalizing the contract, exchanging accurate and complete business information, and maintaining confidentiality to prevent misuse or unfair competitive practices.²²³

Franchise agreements also may include additional, mutually agreed-upon responsibilities beyond statutory obligations. These obligations must be legally and ethically permissible, binding, and enforceable. The contract should clearly outline them to confirm that both parties understand and follow their commitments.

Article 334 of the Mongolian Civil Code establishes these obligations and operational clarity and maintains the integrity of the franchise system. It guarantees that the franchisor is required to protect the cooperation program, provide support, and provide ongoing training and improvements to maintain its long-term viability.

Responsibility of the parties

Franchisee compliance and financial responsibilities are essential for maintaining the integrity of franchise operations. Obligations include the contract, payment commitments, and proper use of transferred rights and intellectual property.

Legal safeguards include restrictions on unauthorized transfers, brand control, and sublicensing. Additionally, there are mutual obligations, including exchanging operational information, confidentiality requirements, and protecting proprietary business knowledge between the franchisor and franchisee.

Remedies for Breach of Contract

The franchise agreement should establish mechanisms for addressing breaches, including the right to demand compliance, seek damages and reimbursement for financial losses, request non-violation enforcement, and withdraw or terminate the contract in severe or irreparable breaches. These provisions allow both parties to meet their obligations and provide legal avenues for resolving disputes related to non-compliance.²²⁴

²²² This Section shall be used with the Law on Advertisement of Mongolia. “See also,” Law on Advertisement, MGL, 2002, Section 23.

²²³ Civil Code, MGL, 2002, Section 334.3

²²⁴ *Ibid*, MGL, 2002, Section 338.2

For instance, upon termination of a franchise agreement, the franchisor has the right to impose a non-compete clause that prohibits the franchisee from engaging in competing business activities within a defined geographical area for up to one year. This regulation prevents the misuse of proprietary business knowledge, customer base, and operational strategies.

However, Section 337 of the Civil Code requires that if such a restriction significantly limits the franchisee's economic freedom, the franchisor must compensate the franchisee for the financial losses incurred due to the limitation.²²⁵

4.6. Duty to Provide Pre-Contractual Information in Franchise Agreements

Under the fundamental principles of civil law, a contract's parties must evaluate its benefits and risks before finalizing the agreement. In the franchise context, international standards establish a specific duty for the franchisor to provide essential information to the franchisee before signing the franchise agreement.

A trust relationship is formed before finalizing a contract during franchise negotiations, requiring the franchisor to maintain complete transparency and disclose information in good faith. It encompasses sharing financial projections derived from current franchise units, a credible timeline for achieving profitability, and all critical business information in a documented form.

This duty prevents the information asymmetry between the parties. As the developer and operator of the franchise system, the franchisor possesses comprehensive knowledge regarding the business model, profitability, and operational complexities. In contrast, the franchisee, who must make a substantial initial investment, needs access to detailed explanations and relevant disclosures to make an informed decision.²²⁶

The franchisor's legal duty to provide pre-contractual information obligates full disclosure; failure to comply may grant the franchisee the right to refuse contract entry, request cancellation of pre-contractual representations, and seek remedies under Article 225 of the Civil Code, including damages and legal recourse.

However, the Mongolian Civil Code's franchise legal regulation does not provide detailed regulation on the franchisor's obligation to disclose information before concluding a contract. In particular, there is no list of items to be disclosed, and it is not regulated how long before concluding a contract these documents must be sent to the franchisee.

These legal shortcomings suggest that the above regulation, considered the most important in concluding a franchise contract, has not been appropriately regulated in the Civil Code.²²⁷

²²⁵ This section shall be used with the Competition Law of Mongolia. See also: Law on Competition, MGL, 2010, Section 6.1.

²²⁶ Author's own: The Civil Code outlines disclosing information for franchise agreements in a limited way.

²²⁷ The Civil Code, 2022, 338.1. Parties shall be liable for implementing contractual obligations and the accuracy of information provided.

The duty of disclosure in franchising necessitates distinguishing between misrepresentation, where false or misleading information induces contract signing and justifies termination and damages, and omission, where failure to disclose material facts creates liability. To prevent these issues, franchisors must be legally required to provide accurate, comprehensive pre-contractual information and confirm transparency in franchise agreements.²²⁸

4.7. Liability Under the Franchise Agreement

The Civil Code establishes explicit liability provisions governing franchise agreements. The franchisee's primary financial obligation is the timely payment of franchise fees, including fees for using the franchisor's trademark and intellectual property rights. Failure to comply results in late payment penalties, calculated as a percentage of the unpaid amount for each day of delay, and may lead to contract termination if delays persist over an extended period.²²⁹

According to the Civil Code, the franchisor does not guarantee the franchisee any income or profit during the agreement term and bears no liability for business performance risks.²³⁰

Section 338.4 states that if the franchisee incurs damages during operations, they are solely responsible for those damages. The assignor (franchisor) is not liable for any contracts the franchisee makes with clients, emphasizing the franchisee's autonomy in managing their business and interactions with third parties.

Suppose a party to a franchise agreement provides misleading, false, or incomplete information that influences the other party's decision to contract. In that case, the injured party has the right to withdraw under the general provisions of Sections 225 and 338 of the Civil Code of Mongolia and seek compensation for damages resulting from reliance on incorrect information.²³¹

Article 338 outlines the parties' liability in a franchise agreement, specifying that both the franchisor and franchisee are responsible for fulfilling their contractual obligations and ensuring the accuracy of the information provided. The franchisee's liability is limited to their contractual obligations and does not extend to broader business outcomes or customer-related losses. While the franchisee is liable for any losses or expenses incurred due to their obligations, they are not responsible for the income generated by the franchise or for losses caused by negligent actions toward customers.

Article 338.3 clarifies that the franchisor is not responsible for the success of the franchisee's business, as business outcomes are part of the usual risks of entrepreneurship. While the franchisor is obligated to fulfill its contractual duties, the franchisee bears the ultimate responsibility for the performance and success of their business.

²²⁸ *Ibid.*

²²⁹ The Law of Obligations, Chapter 19 of the Civil Code.

²³⁰ Commentary on the Civil Code, 2022, 338.1-338.4

²³¹ *Ibid.*, 225, 338.

Sections 338.1 and 338.2 emphasize that each party must fulfill their contractual obligations, and failure to do so results in liability for the consequences of the breach. The type of breach determines the specific consequences, such as the right to invoke remedies like those in Section 253 for defective property transfers. If the franchisor provides incorrect information but is not found guilty of a breach, they are not required to compensate for damages; however, the other party may have the right to terminate the contract early.

4.8. Grounds for Termination of the Franchise Agreement

As a long-term legal relationship, a franchise contract may be unilaterally terminated for breach of contract if the franchisee fails to remedy a violation after a franchisor's warning, becomes insolvent or persistently defaults on payments, or neglects key contractual obligations such as quality standards, operational requirements, or financial commitments.²³²

Sections 336.2 and 336.3 outline the conditions for automatic termination and renewal of a franchise agreement. If the agreement exceeds ten years without a specified term, either party may terminate the agreement after one year's notice. Additionally, the contract may be extended beyond its original term, subject to mutual consent, for a definite or indefinite period, guided by principles of trust and cooperation.

A franchise contract may also be terminated if the franchisee's performance fails to meet agreed-upon standards or if their conduct harms the brand's reputation or violates franchise policies. It can be considered a termination due to defective performance.

A franchise contract may be declared invalid and void from the outset if entered into through deception or misrepresentation. The franchisor can unilaterally terminate the agreement if the franchisee falsely represents their financial status. In contrast, the franchisee may invalidate the contract if the franchisor provides false information or fails to disclose material details.²³³

Legal Consequences of Termination

Upon termination of a franchise agreement, all contractual obligations cease except for enforceable confidentiality and non-compete clauses. The franchisee must discontinue using the franchisor's intellectual property, trademarks, and proprietary business methods and return franchisor-owned assets unless otherwise specified.

Additionally, if the agreement requires transferring customer accounts to the franchisor or a designated third party, the franchisee is entitled to compensation under Section 418 of the Civil Code.²³⁴

²³² Enkhzul, Standard Terms of Contract, 2003, 65.

²³³ Buyankhishig, Law of Obligations, 2013, 125.

²³⁴ *Ibid*, 127.

CASE LAW

Franchise Disputes in Mongolia

1. Zoomline v. Monmatch LLC

Case Overview

The case centers on a commercial dispute between Zoomline, a Chinese company, and its official distributor in Mongolia, Monmatch LLC. The dispute arose when a Mongolian purchaser of an 80-ton hydraulic truck crane purchased from Monmatch LLC discovered that the crane was not an 80-ton model but a 70-ton model, leading to the purchaser's exclusion from a construction project tender.

The purchaser paid for the crane based on specifications stating it was an 80-ton model. However, it was later revealed that the crane did not meet the claimed specification, harming the purchaser's opportunity to participate in the tender. The purchaser claims that Monmatch LLC misled them about the crane's specifications, potentially leading to litigation.

Potential Legal Frameworks

Commercial Agreement: If treated as a standard commercial dispute, the legal claim would focus on the relationship between the purchaser and the distributor. It would likely involve a breach of contract, misrepresentation, or failure to meet the agreed-upon terms without involving the parent company, Zoomline LLC.

Franchise Agreement: In a franchise agreement, the legal claim could be broader, involving both the distributor (Monmatch LLC) and the parent company (Zoomline LLC). In this case, the dispute would involve allegations of breach of franchise terms, misrepresentation, and violation of franchise laws, especially given that Zoomline is the parent company.

Differences in Legal Approach

Commercial Agreement: The legal proceedings would be confined to the purchaser and the distributor. Any damages or resolution would likely be limited to the parties involved in the commercial contract. The court would examine the terms of the purchase agreement, focusing on misrepresentation or breach of warranty.

Franchise Agreement: If treated as a franchise-related dispute, the claim could extend to the franchisor (Zoomline), which may be responsible for ensuring that its franchisees uphold the brand's quality and specifications.

This could involve violations of franchise disclosure rules or other obligations under franchise law. In a franchise agreement context, the court would likely examine whether the distributor (Monmatch LLC) acted within the scope of its franchise obligations and whether Zoomline was responsible for the issue.

Gaps in Mongolian Franchise Legislation

The case highlights significant gaps in Mongolian franchise law, particularly concerning the absence of clear definitions for terms such as “franchise distributor,” “franchise appurtenant to the land,” and “master franchise.” These definitions may be necessary for resolving disputes like this one. The lack of a detailed regulatory framework for franchise relationships means that this case may have to be decided under general commercial law principles, potentially leading to inconsistent rulings in franchise-related disputes.

Recommendation for Future Legislation: The absence of a detailed franchise agreement regulation in Mongolia makes it challenging to address disputes involving franchise relationships adequately. To improve legal clarity, it is essential to define key terms in franchise law, such as:

“Franchise distributor”

“Master Franchise”

“Unfair Contract Terms”

“Time frame for disclosure of information”

“The list of Items to disclose”

Conclusion:

Clearly defining misrepresentation and breach of contract in commercial transactions is essential for legal certainty and fairness. A comprehensive approach must reinforce each party’s responsibility to maintain franchise operations’ integrity and prevent franchisees’ fraudulent or misleading conduct. The case underscores Mongolia’s need for clear legal frameworks for franchising disputes. If the case is treated purely as a commercial dispute, it limits the scope of legal analysis to the purchaser and distributor, leaving the parent company out of the picture. However, if the case is framed within a franchise law context, the parent company (Zoomline LLC) could be held accountable for its role in the franchise relationship, emphasizing the importance of developing detailed regulations in Mongolia.²³⁵

2. *Golden Properties (Plaintiff) v. Property Key (Defendant)*

Case Overview

The case revolves around a payment dispute between two companies, Golden Properties (Plaintiff) and Property Key (Defendant), under an agreement involving the operation of real estate brokerage activities. The agreement outlined the transferor’s (Golden Properties) grant of the right to operate a real estate brokerage business to the transferee (Property Key) in exchange for royalties, a marketing fund, system fees, and insurance payments.

²³⁵ This case is a dispute that has not gone to court. It is being handled by a law firm, and the parties are offering mediation.

However, the defendant failed to make timely payments as stipulated, causing delays. After some negotiation, the defendant made a partial payment and proposed a settlement, which was accepted by both parties, leading to the closure of the case.

Dispute Analysis

Nature of the Agreement: The agreement between the parties can be interpreted as a hybrid between a real estate contract and a franchise agreement. While the terms involving royalties, marketing funds, system fees, and insurance resemble typical franchise arrangements, the main activity- real estate brokerage- does not explicitly fit within traditional franchise operations. This complicates the legal framework for resolving disputes, making categorizing the agreement as either a franchise or a real estate transaction difficult.

Payment Delays and Breach of Contract: The main issue is the defendant's failure to comply with the payment terms outlined in the agreement, which led to delays in the agreed-upon payments. In standard franchise agreements, payment terms and the consequences of failing to meet these terms are usually strictly enforced.

At the same time, real estate contracts may be more lenient, depending on the specifics. The defendant's delay thus demonstrates a significant breach of the agreement's terms, with potential consequences such as penalties, termination, or renegotiation, which could have been outlined more explicitly in the contract.

Partial Payment and Settlement: The defendant's partial payment and subsequent settlement offer suggest that both parties aimed to avoid prolonged litigation. By accepting the settlement, the plaintiff may have prioritized resolving the matter quickly over pursuing the full amount owed. The settlement suggests an element of flexibility in real estate transactions but highlights how parties may not always fully comply with agreed-upon payment schedules.

Legal Framework Analysis

Real Estate Agreement vs. Franchise Agreement: This case exemplifies a potential misuse of elements in real estate contracts and franchise agreements. In traditional franchise relationships, the franchisor (Golden Properties) provides a set of systems, services, and branding in exchange for payment.

Property Key was obligated to pay royalties, marketing, and system fees in this case- characteristics common to franchise agreements. However, since the underlying business activity is real estate brokerage, which typically does not involve a franchise relationship, using franchise-like terms in the agreement may have complicated the dispute resolution process.

Implication of Misused Contract Elements:

The combination of real estate and franchise agreement elements may confuse the enforcement of contract terms, particularly those relating to payment obligations and penalties.

Given the agreement's hybrid nature, the parties may have lacked clarity on their respective rights and obligations, leading to delays and confusion about enforcement.

Franchise-like Terms and Payment Disputes: Stronger provisions would likely enforce payment terms and clear penalties for non-payment if the arrangement were more clearly defined as a franchise agreement. In contrast, under real estate brokerage agreements, payment structures may be more flexible, potentially leading to disputes regarding timing and amounts owed.

Evaluation of Settlement and Case Closure: The case ended with a settlement after partial payment, which suggests both parties recognized the costs and uncertainties of litigation. While this resolution avoided further legal escalation, it also raised questions about the enforceability of similar agreements in the future. The flexibility in the settlement may set a precedent for future cases where parties to agreements with mixed elements (real estate and franchise) seek to resolve disputes through negotiation rather than strict enforcement.

Recommendations for Future Agreements

Clarification of Terms: It is essential to clarify whether the agreement is primarily a real estate or franchise agreement. Each type of agreement has different implications for payment structures, rights, and obligations. More explicit definitions could prevent future disputes and confusion.

Inclusion of Clear Payment Terms

Clear and enforceable payment schedules should be established to avoid situations like this. Penalties or late fees should also be clearly outlined for non-compliance.

Addressing Hybrid Agreements: In cases where agreements involve hybrid elements (such as real estate brokerage and franchise-like terms), adopting a more integrated approach that explicitly addresses both aspects and clarifies the terms of operation may be beneficial.

Dispute Resolution Mechanisms: The agreement should incorporate a dispute resolution clause to encourage negotiation or mediation before litigation. This clause can specify the steps both parties should take in case of a breach and provide a more straightforward path toward resolution.

Conclusion

The case of *Golden Properties v. Property Key* highlights the challenges arising from agreements that combine elements of real estate transactions and franchise arrangements. The dispute was resolved through a settlement, avoiding prolonged litigation, but it raises concerns about the potential for confusion in similar future cases. More precise terms in the agreement, particularly around payment obligations, and a more precise definition of the agreement's nature would help mitigate such disputes.²³⁶

²³⁶ Civil Court of First Instance in Orkhon Province. Case Number. 142/2024/00931; "See," in https://shuukh.mn/single_case/152245?daterange=2020-02-01%20-%202024-12-01&id=1&court_cat=1&bb=1

Chapter Conclusion

As recognized under the Civil Code of Mongolia, franchise agreements are considered contract law. While the Civil Code outlines general provisions of franchise agreements, it lacks more specific and comprehensive regulations for effective governance of franchise relationships.

One significant shortcoming is the absence of a comprehensive definition of franchising within the Civil Code. Moreover, franchise categories are not defined, which may make it difficult to apply uniform legal principles. For instance, case studies further highlight the challenges posed by these legal gaps. The undefined nature of key franchise terms, such as “franchise distributor” and “master franchise,” contributes to inconsistent interpretations in legal disputes.

The next problem is the legal status of franchisors and franchisees, and the eligibility of individuals and entities to participate in franchise systems remains undefined. Furthermore, the Civil Code does not provide clear regulations regarding the ownership, representation, and legal standing of business entities engaged in franchising.

Another gap is the lack of differentiated regulations based on franchise agreement types. While specific standard provisions are necessary in all franchise agreements, the legal framework does not accommodate variations based on the nature of the franchise relationship. Additionally, despite formal contract requirements, there is no specific mandate for franchise agreements to be in written form, creating potential ambiguities in enforcement.

In their pursuit of expanding their franchise networks, Franchisors often impose strict contractual terms on franchisees. However, the absence of adequate legal safeguards within the Civil Code means that franchise agreements may not always provide equitable protection for franchisees. The general fairness clause states that “the parties shall be fair to each other” is insufficient to prevent exploitative contract terms and unfair dealings.

Finally, franchisors’ and franchisees’ legal obligations are not broadly defined and lack the necessary detail for practical implementation. For instance, the provision stating that “the parties must exchange mutually necessary documents” does not specify the scope or timing of such disclosures. This vagueness probably complicates compliance and enforcement.

A particularly concerning omission is the lack of a list of items defined as pre-contractual disclosure obligations for franchisors. The Civil Code does not specify which information must be disclosed to prospective franchisees or the timeframe for such disclosures. Given the importance of transparency in franchise relationships, the absence of these provisions represents a significant regulatory deficiency.

Chapter 5. International Legal Instruments for Regulating Franchising

5.1. Principal International Legal Instruments for the Franchising

The regulation of franchising is an expanded area of study, particularly when examined within the context of key international legal instruments.²³⁷ Moreover, one of the primary challenges in integrating franchise regulatory framework is coherence among legal regimes.²³⁸ Hence, despite variations in legal systems, nations try to attain common regulation through mutually agreed-upon norm-setting.²³⁹

The legal environment for franchising relies not only on domestic law but also on a unified regulatory framework.²⁴⁰ Therefore, as part of my research, I compared international documents, particularly EU principles and directives regarding respected franchise issues.²⁴¹ The chapter highlights explicitly legal regimes, such as those of the European Union, as relevant examples that illustrate the application of international frameworks in regulating franchising.²⁴²

The expansion of franchising in several countries has been attributed to the inadequacy of regulations from a single country's laws and the challenge of jurisdictions agreeing on model guidelines. That is why the short comparison conducted in this chapter can be considered the foundation for the comparative research included in the next chapter of this thesis.²⁴³

Common Documents

Firstly, the United Nations Convention on Contracts for the International Sale of Goods establishes a comprehensive code governing contract formation and buyer and seller rights and obligations. The Convention applies to contracts for the distributorship sale of goods between parties whose places of business are in different States.²⁴⁴

²³⁷ Courtenay Atwell, Jenny Buchan, *The Franchise Fulcrum: The Legal System's Contributions to Research about Power and Control in Business Format Franchising*, Journal of Marketing Channels, 2014, Volume 21, 180-195.

²³⁸ Geoffrey Garret, *The Politics of Legal Integration in the European Union*, Journal of International Organization, 1995, Volume 49, 171-181.

²³⁹ Grant Gilmore, *Legal Realism: Its Cause and Cure*, The Yale Law Journal, 1961, Volume 70, 1037-1048.

²⁴⁰ Catherine Valcke, *Comparative History and the Internal View of French, German, and English Private Law*, Canadian Journal of Law & Jurisprudence, 2006, Volume 19, 133-160.

²⁴¹ Phil Syrpis, *The Influence of the EU on UK Labor Law before and after Brexit*, 2022, Industrial Law Journal, Volume 51, 802-830.

²⁴² Aldo Frignani, John Pratt, *Termination and Non-renewal of Franchise Agreements in the European Union*, Franchise Law Journal, 2017, Volume 37, 15-42.

²⁴³ Henry Steiner, *The Development of Private International Law by International Organizations*, Proceedings of the American Society of International Law at Its Annual Meeting, Cambridge University Press, 1965, Volume 59, 38-52.

²⁴⁴ *United Nations Convention on Contracts for the International Sale of Goods*, UN Commission on International Trade Law, 1964, Article 1 (1).

Secondly, the Model Law on International Commercial Arbitration and Electronic Commerce indirectly influences the development of franchising. These agreements set trade and intellectual property protection rules, shaping the nature of transnational business transactions.²⁴⁵

Thirdly, Article 8 of the Paris Convention for the Protection of Industrial Property asserts that in all member countries, a business's name, regardless of its inclusion in the trademark system, is protected automatically without needing an application.²⁴⁶

International documents commonly refer to a collection of model laws that regulate franchise agreements across national borders.

Such rules are intended to enhance an environment that supports franchising and encourages entrepreneurship. For instance, significantly, jurisdictional approaches directly influence international master franchise agreements in different ways.²⁴⁷

International franchise documents are governed by generally accepted principles unless explicitly stated otherwise in the laws of that country. In other words, in a dispute or a regulatory conflict not specified in that country's laws, the resolution follows standard regulatory procedures, circumventing the peculiarities of any country's laws. For example, the principles of International Commercial Contracts of 2007 by Unidroit should be noted here.

The Master Franchise Arrangement outlines the consent and right to use licensed assets and trademarks, the agreement's terms, the financial relationship or revenue schedule between the parties, the source of supply or income from the franchise transferor, and sub-franchising. In 2000, the International Chamber of Commerce developed the Model International Franchising Contract, a document defining the rights and obligations of parties in franchise agreements globally. It serves as a standardized template for agreements across borders.²⁴⁸

Subsequently, adopting the Model Franchise Disclosure Law, the international private law parties had the chance to define the disclosure scope before signing the contract. Besides being directly used by contracting parties conducting business internationally, these documents remain a valuable resource for updating the laws of various countries.²⁴⁹

These documents have discussed the international aspects of franchising in their respective

²⁴⁵ Model Law on International Commercial Arbitration 1985, Amendments as Adopted in 2006.

²⁴⁶ Antony Taubman, *The Public Domain and International Intellectual Property Law Treaties*, ANU College of Law Research Paper, 2007 (07-17).

²⁴⁷ Keith Kanouse, *Franchising Internationally*, 1996, "See", in https://www.kanouse.com/sites/default/files/Franchising_Internationally.pdf

²⁴⁸ Ayşe Güvercin Şahan, *ICC Model International Franchising Contract as a Source of Lex Mercatoria*, *Public and Private International Law Bulletin*, 2020, Volume 40, 1403-1432.

²⁴⁹ Philip Zeidman, *With the Best of Intentions: Observations on the International Regulation of Franchising*, *Stanford Journal of Law, Business & Finance*, 2014, Volume 19, 237-280.

publications, offering valuable guidance for managing master franchise arrangements.²⁵⁰

Model Franchise Disclosure Law

Abell concluded that the UNIDROIT study on franchise regulations is limited to pre-contractual disclosure and does not examine the contents of franchise agreements or how they might be regulated. He also remarked that exploring the issues related to disclosure is somewhat superficial.²⁵¹

The Model Franchise Disclosure Law applies to franchises to be granted or renewed for operating one or more franchised businesses within the industry. The law provides a framework designed to harmonize franchise laws across different jurisdictions. Its primary purpose is to confirm fairness and transparency while protecting franchisees from unfair practices by franchisors.

Verifying that franchisees have access to information before agreeing to a contract is essential in establishing a solid foundation for the contractual relationship. It also strengthens franchisees' legal standing by creating a basis for seeking legal remedies when a franchisor fails to comply with mandatory disclosure obligations.

Under the provisions outlined in these disclosure laws, franchisors must provide prospective franchisees with comprehensive information regarding the franchise, including financial performance, associated fees, contractual obligations, and the franchise's business history. These requirements certify that potential franchisees can make informed decisions when entering a franchise agreement.²⁵²

The specific regulations within the framework of the Model Law can be helpful tools for various legal systems and valuable sources for understanding the franchising regulatory environment. For instance, regulations require a franchisor to provide every prospective franchisee with a disclosure document accompanied by the proposed franchise agreement at least 14 days before the franchisee signs.

Significantly, the disclosure document is supposed to be updated within a set number of days after the end of the franchisor's fiscal year. The information disclosed in this document includes broad reports or types of documents, and the prospective franchisee must acknowledge in writing the receipt of the disclosure document upon the franchisor's request.

If the disclosure document or notice of material change has not been delivered within the specified timeframe, contains a misrepresentation of a material fact, or omits a material fact, then the franchisee may terminate the agreement with 30 days prior written notice to the franchisor. Therefore, the Model Law establishes that prospective franchisees intending to invest in

²⁵⁰ Florea (2022) 12-22.

²⁵¹ Abell (2013) 5.

²⁵² Model Franchise Disclosure Law, UNIDROIT, 2002, Article 6 (1) (A).

franchising receive essential information about franchise offerings, allowing them to make informed investment decisions.²⁵³

In my evaluation, model laws are more flexible than strict rules. Additionally, they allow for the inclusion of provisions that experts believe represent the most suitable solution to a specific problem. According to the model law, in master franchising, the franchisor grants the sub-franchisor the right to operate franchise outlets and grant sub-franchises to franchisees in the territory the franchisor has authorized for development. Implementing model laws by various countries facilitates the establishment of global standards in franchising.

Guide to International Master Franchise Arrangements

As Stetsiuk and others noted, the Guide to International Master Franchise Arrangements provides a comprehensive examination of the entire lifecycle of this type of arrangement, from the negotiation and drafting of the master franchise agreement and other associated agreements to the end of the relationship. It primarily addresses the positions of the parties directly involved, namely, the franchisor and the sub-franchisor. However, in cases deemed particularly important, the positions of others associated, such as sub-franchisees, are also included.²⁵⁴

Indeed, the form of collective rights known as the business format is increasingly coming to symbolize franchising. In business format franchising, a franchisor elaborates on and tests a specific business procedure, whether for the distribution of goods or the supplying of services, which it then grants to franchisees to administer. Regarding master franchise agreements, the franchisor grants another person, the sub-franchisor, the right, which in most cases will be exclusive, to grant franchises to sub-franchisees within a specific territory and/or to open franchise outlets themselves.²⁵⁵

According to the Guide, the defined legal barriers of franchising highlight the significant role of the legal environment in the host country in identifying the most suitable vehicle. For franchising to operate effectively, there must be comprehensive legislation on commercial contracts, sufficient company law, intellectual property regulations, and a robust enforcement of the rights provided by this legislation.

While specific laws are a prerequisite for successful franchising, additional legal factors may influence whether franchising is suitable. As emphasized in the Guide, the franchisor will also need to adapt the franchise agreement and ancillary documents to meet the local requirements of the intended host country.²⁵⁶

²⁵³ *Ibid*, Art.6, (2)

²⁵⁴ Bohdan Stetsiuk, Yurii Miroshnychenko and Pavlo Dudko, *International Franchise Agreement*, Baltic Journal of Economic Studies, 2018, Volume 4, 332-337.

²⁵⁵ Guide to International Master Franchise Arrangements, UNIDROIT, 2007, Chapter 5, 65-76.

²⁵⁶ *Ibid*, Chapter 1, 29-30.

5.2. European Union Legal Instruments Relevant to Franchising

I believe that the European Union's legal acts represent a form of international law.²⁵⁷ Therefore, I tried to compare some legal documents issued by the European Union as examples of international legal instruments. Regarding contract rules in the EU, the franchise system is defined more broadly, encompassing the transfer of rights and the nature of relationships between suppliers and dealers in selling products.²⁵⁸

Abell has concluded that franchising's failure to reach its full potential in the European Union is partly due to the dysfunction of law coordination. The varying approaches to franchising regulation in the EU arise from the absence of a unified framework at the EU level. Instead, franchising is governed by national laws, EU competition rules, and general commercial and contract law.²⁵⁹

EU Vertical Block Exemption Regulation governs some aspects of franchising but is not explicitly tailored to franchise relationships. However, the ambiguity surrounding permissible territorial restrictions, resale price maintenance, and exclusive supply obligations makes it challenging for franchisors to structure agreements without risking non-compliance. EU directives could be the most appropriate approach to regulating franchising in the EU, as they balance the need for modification with respect for member countries' sovereignty. A directive outlines goals and standards for mandatory pre-contractual disclosure requirements and fair contract terms but allows each country to determine how to implement them.²⁶⁰

The Principles of European Contract Law (PECL)

Previously, the communication on European Contract law outlined the European Commission's views, proposals, and strategies for enhancing legal integration and facilitating cross-border transactions within the internal market.²⁶¹ Later, the European Commission published The Principles of European Contract Law and the Draft Common Frame of Reference, which provide detailed principles and definitions.²⁶²

PECL, a general guideline for the contract law of the European Union's member countries, emphasizes that franchising is a broad legal relationship governed by competition and intellectual property laws. Although not specific to franchises, PECL establishes principles that directly apply to franchising.

²⁵⁷ Judgment of the Court of 5 February 1963. NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration. Tariefcommissie - Netherlands. Case 26-62. Summary 3.

²⁵⁸ Commission Regulation, 4087/88 of 1988, Article 85 (3) of the Treaty to categories of franchise agreements.

²⁵⁹ Mark Abell, Legal Perspective of The Regulatory Framework and Challenges for Franchising in the EU, European Parliament's Committee on the Internal Market and Consumer Protection, 2016, 36.

²⁶⁰ Abell (2013) 179.

²⁶¹ Martijn Hesselink, *Progress in EU Contract Law*, European Review of Contract Law, 2022, Volume 18, 281-302.

²⁶² David Schmid, *Do We Need a European Civil Code*, Annual Survey of International & Comparative Law, 2012, Volume 18, 263-293.

As Fézer argued, the PECL influences amendments to the legal framework for contracts across member countries and serves as a unique *lex Mercatoria* for European businesses.²⁶³

Franchising typically encompasses elements of various legal relationships, including intellectual property, commercial agency, distribution, lease, or real estate agreements. The PECL acknowledges that such hybrid relationships necessitate principles that account for overlapping obligations and rights. Consequently, introducing intellectual property into economic circulation and promoting competition can be considered key objectives of the legal regulation of franchise agreements. According to the PECL, most commercial agencies and distribution agreements do not involve intellectual property rights.²⁶⁴

The PECL establishes that parties must act in good faith and engage in fair dealing at all stages of the franchise contract, including negotiation, execution, and termination. For example, under Article 1:102, franchise parties are free to structure contracts as they wish as long as they follow mandatory rules and principles of fairness. Additionally, franchisors must disclose material information to prospective franchisees during pre-contractual negotiations, and franchisees should act loyally within the franchised system by following operational guidelines.

As stated in Article 2:301, the PECL imposes a duty to provide relevant and accurate information during pre-contractual negotiations, including financial performance expectations, obligations regarding fees, royalties, investments, territorial exclusivity, and termination conditions.²⁶⁵

Article 1:305 (I) includes a provision that restricts parallel competition following the termination of the franchise agreement. These principles govern the relationships before and during the termination of the franchise agreement. Notably, intellectual property protection remains effective even after the agreement ends.

Article 6:101 establishes that parties are required to fulfill their contractual obligations as stipulated. Franchisors are accountable for providing guidance, manuals, and updates on business practices. Conversely, franchisees follow the franchisor's operational guidelines and maintain quality standards.

Article 4:110 addresses the issue of unfair contract terms. It protects terms that create a significant imbalance between the parties' rights and obligations to the detriment of one party. Franchising agreements often include terms that reflect the franchisor's dominant position.

Consequently, Article 4:110 protects franchisees against excessively one-sided terms, and Article 6:111 aligns with broader principles in European contract law that encourage fairness between contracting parties, especially when interpreting and performing contracts.

²⁶³ Tamás Fézer, *The Invalidity in the Principles of European Contract Law-Common Cores and Alternate Ways*, European Integration Studies, Volume 18, 2022, 84-92.

²⁶⁴ Hesselink & Others (2006) 91-143.

²⁶⁵ The Principles on European Contract Law, Chapter 1: Article 1:102: Freedom of Contract. Last Published in 2003.

Articles 9:301 to 9:305 belong to Chapter 9, which deals with non-performance and remedies in general. These provisions outline essential remedies for a party if the other party fails to meet their contractual obligations. However, I would conclude that the PECL's disadvantage is its lack of binding legal force, which restricts its practical application and generates uncertainty in cross-border disputes where parties or courts may prioritize national laws over these principles.²⁶⁶

Draft Common Frame of Reference (DCFR)

The general concept of European civil law pertains to the initiative to harmonize jurisdictions among member countries. For example, in cases where there is no selection of regulation, the applicable law should be determined by the rule specified for the relevant type of contract. Although there is no specific "Franchise Law" in the European Union, franchise agreements are governed by DCFRs and directives that regulate the relationship between contracting parties within the EU.²⁶⁷

As Terryn emphasized, the DCFR can serve as a basis for developing an optional instrument and has significant potential as a tool or frame of reference for improving law-making. For both tasks, it is essential to remember that private law rules do not stand alone but operate within a comprehensive body of law when selecting parts of the DCFR. Therefore, the DCFR can be utilized as a source for an essential instrument in contract law.²⁶⁸

DCFR drafts were developed based on the European Union's private law studies and provide more detailed guidance than other legal documents. This significantly influences the policies of member countries regarding contract law. For instance, principle 8 of the model rules stipulates the duty of franchise disclosure before the contract is concluded, while principles 9 and 10 outline the ethical duties of the parties in franchise agreements.

According to the DCFR, Franchising is distinct from distribution and other similar contracts. Additionally, it is clarified that the primary requirement for the franchise business lessor is to furnish information regarding their business experience.

The provisions for commercial agency, franchise, and distributor agreements outlined in Part 'E' of the DCFR establish general conditions such as pre-contractual requirements and compensation for damages in the event of contract extension or termination.²⁶⁹

Under the DCFR, a franchising party involved in contract negotiations must, following good commercial practices, provide the other party with adequate information within a reasonable timeframe before the contract is finalized.

²⁶⁶ *Ibid*, Article 2:301: Negotiations Contrary to Good Faith, 1:305: Imputed Knowledge and Intention.

²⁶⁷ Regulation 593/2008 of the EU Parliament, Article 12-19, Journal of the European Union, Volume 177, 6-16.

²⁶⁸ Evelyne Terryn, The Common Frame of Reference: An Optional Instrument, EU Parliament, Brussels, 2010, 14.

²⁶⁹ Principles, Definitions and Model Rules of European Private law, Draft Common Frame of Reference, Outline Edition by the Study Group on a European Civil Code, European Law Publishers, 2009, 194.

According to Article 2:306 of the DCFR, if the franchise agreement is canceled or either party terminates the contractual relationship, the party whose products are being marketed must repurchase the other party's remaining stock, spare parts, and materials at a fair price unless the other party can reasonably resell them.²⁷⁰

In my evaluation, the DCFR's non-binding nature restricts its practical utility, as it depends on voluntary adoption by parties or legislators, resulting in uncertainty. Furthermore, the DCFR has been criticized for inadequately addressing the differences in legal traditions across European jurisdictions, which may impede its acceptance as a harmonizing instrument.

Hence, DCFR may face criticism for its complexity and lack of accessibility, as its extensive provisions and technical language may be difficult for practitioners and parties to navigate. A significant drawback of the DCFR in franchising is its limited focus on the complexities of franchise relationships, especially the balance between franchisee autonomy and franchisor control, which diminishes its effectiveness in addressing specific legal and operational challenges.

Codes of Ethics for Franchises

Franchise regulations within the European Union can be appropriately defined by examining the Code of Ethics established by the European Franchise Federation and the specific legislative frameworks implemented by individual member countries.

Diaz's comparative research on franchising in European countries indicates that the Block Exemption and the Code of Ethics for franchising are among the primary regulations addressing franchise issues within the European Union. Although codes of ethics are not legally binding, they offer guidance for contracting parties engaged in this agreement, the study also noted. In particular, this type of document is expanding into an instrument for regulating franchise relations internationally.²⁷¹

Preble and Hoffman's study shows that franchise relationships are typically well-regulated by their respective codes. More than 75 percent of these codes address the four stages: initiation, written agreement, implementation, and franchise termination.

Their research, which analyzed franchise codes of conduct from eight countries, revealed that 89 percent of the Codes of Ethics oversee matters such as good faith, information disclosure, the rights and obligations of the parties, and grounds for contract termination.

Based on this result, it may be reasonable to conclude that a franchise Code of Ethics operates as a legal instrument.²⁷²

²⁷⁰ DCFR, IV. E.- 2:101: Pre-Contractual Information Duty, 2:306: Stock, Spare Parts, and Materials.

²⁷¹ Diaz (2008) 19.

²⁷² John Preble, Richard Hoffman, *The Nature of Ethics Codes in Franchise Associations Around the Globe*, Journal of Business Ethics 1999, Volume 18, 239-253.

The European Code of Ethics for Franchising provides a comprehensive framework for evaluating ethical conduct within franchising. It serves as a standard for best practices and fair dealings between franchisors and franchisees across Europe. According to the Code of Ethics, the franchise agreement must comply with national laws, European community laws, and the Code of Ethics, along with any National Extensions. The Code of Ethics, commonly referenced in European countries, is the primary resource for most organizations and individuals involved in franchise activities.²⁷³

Vertical Block Exemption (VBER)

Franchising typically involves a mix of various vertical restraints related to the products being distributed, such as exclusivity, quality requirements, assortment, customer demographics, and specific restrictions on internet sales. Franchising represents the vertical production process of delivering goods or services to customers.²⁷⁴

Franchise agreements often include non-compete clauses stipulating that if franchisees exit the franchise system, they are prohibited from engaging in similar business activities within the same industry or territory for a specified period, typically two years.²⁷⁵ These restrictions are designed to protect the franchisor's business interests and maintain that the franchisee does not use proprietary knowledge or relationships gained through the franchise system to compete directly with the franchisor.²⁷⁶

Analyzing the European Union's regulations on vertical restraints shows distinct approaches to contract law. The EU governs vertical restraints through Articles 101 and 102 of the Treaty on the Functioning of the European Union (TFEU), with the VBER and the accompanying Vertical Guidelines offering detailed guidance.²⁷⁷ Since Regulation No. 19/65, the Commission has adopted Regulation No. 772/2004, which grants a block exemption for technology transfer agreements under Article 101(3) of the Treaty.²⁷⁸

Article 101 TFEU prohibits agreements that may affect trade and prevent, restrict, or distort competition. The VBER exempts certain vertical agreements when the supplier's and buyer's market share is below 30 percent. It offers exemptions for agreements that fulfill specific criteria, thereby creating legal certainty for businesses. Certain restrictions, such as resale price maintenance and territorial limits, are considered hardcore and are generally prohibited. As a result, franchise agreements undergo a full review under EU competition law.²⁷⁹

²⁷³ *The Code of Ethics for Franchising*, The European Franchise Federation, 2023, Article 5.1.

²⁷⁴ Christopher Stothers, *Parallel Trade in Europe: Intellectual Property, Competition, and Regulatory Law*, Hart Publishing, 2007, 9.

²⁷⁵ Martijn Hesselink, *The New European Legal Culture*, Kluwer Law International, 2002, 11-75.

²⁷⁶ EU Competition Law Rules Applicable to Antitrust Enforcement. Volume 1, General Rules, 2013.

²⁷⁷ Derek French, Stephen Mayson and Christopher Ryan, *Company Law*, Oxford University Press, 2012, 21.

²⁷⁸ Richard Whish, David Bailey, *Competition Law*, Oxford University Press, 2021, 781.

²⁷⁹ Guy Tritton, Richard Davis, *Intellectual Property in Europe*, Sweet & Maxwell, 2008, 975.

A franchisor cannot implement practices not allowed under competition law, such as vertical or horizontal price-fixing, market sharing, prohibiting passive sales, or imposing a direct or indirect ban on online sales.²⁸⁰

Unfair Contract Terms Directive (UCTD)

The directive governs fair and transparent contractual contract terms, promoting consumer confidence and fair competition within the internal market. Its main objectives are to protect users from unfair contractual terms that create a significant imbalance in rights and obligations between the parties to the detriment of the consumer and to certify that contractual terms are drafted and understandable to the average consumer. The UCTD applies to all contracts concluded by a seller or supplier, which means it encompasses standard terms that have not been individually negotiated.

Individually negotiated terms are excluded unless they were pre-formulated and unavailable for negotiation. Specifically, a franchise term is deemed unfair if it results in a significant asymmetry in the rights and obligations of the parties under the contract to the detriment of the consumer. The assessment of fairness considers the nature of the goods or services, the circumstances surrounding the conclusion of the contract, and all other terms of the agreement.

Therefore, national courts have the authority to evaluate the fairness of a contractual term on their initiative (*ex officio*).²⁸¹

Unfair Commercial Practices Directive (UCPD)

The UCPD has undergone updates and revisions to keep up with changing market conditions, digitalization, and new business practices. For example, recent amendments tackle issues related to online franchise platforms. The UCPD validates fairness in the EU's internal market by establishing clear standards for franchise business conduct and offering strong consumer protections. Each member country appoints national authorities responsible for enforcing the directive. These authorities can take various actions, such as imposing fines and halting unfair practices.²⁸² Moreover, E-commerce directives have been a driving force in advancing cross-border e-commerce within the European Union, enabling businesses to expand their reach by offering products and services throughout the internal market. It establishes comprehensive regulations for online advertising and marketing and consumer protection in the digital space. Additionally, the directive mandates that service providers disclose information such as their legal name, geographical location, and franchise license as part of the electronic contract formation process, thereby enhancing the legal certainty of online transactions.²⁸³

²⁸⁰ Stephen Weatherill, Ulf Bernitz, (eds) *The Regulation of Unfair Commercial Practices under EC Directive 2005/29: New Rules and New Techniques*, Hart Publishing, 2007, 31.

²⁸¹ Council Directive 93/13/EEC of 1993 On Unfair Terms in Consumer Contracts.

²⁸² Directive 2005/29/EC of the European Parliament.

²⁸³ Directive 2000/31/EC of the European Parliament.

Late Payment Directive

The directive seeks to improve business cash flow, mainly by supporting small and medium-sized franchise enterprises (SMEs) by establishing strict regulations regarding payment periods and implementing measures to address late payments. As a result, the directive applies to all commercial franchises, regardless of whether they operate in the private or public sector. It extends to business-to-business (B2B) transactions and interactions between businesses and public authorities (B2G).²⁸⁴

Franchise Agreement Liability

European Union member countries' legal frameworks and practices illustrate a unified approach to contract liability. Essentially, these approaches view contract liability as compensating for or addressing harm resulting from a breach of contractual obligations, reflecting a shared commitment to fairness and accountability in contractual relationships.

Regarding franchise disputes, courts in EU countries typically impose two main types of liability: pecuniary damages and non-pecuniary damages. Pecuniary damages refer to financial compensation covering measurable losses, such as lost profits or operational expenses.²⁸⁵

Additionally, the enforcement of liability for not fulfilling contractual obligations is primarily determined by statutory law and forum selection clauses specified in the franchise agreement. In other words, the underlying legal principles governing contracts in EU member countries underscore the necessity of clearly defining the rights and responsibilities of the contracting parties. For instance, EU regulatory approaches typically include detailed provisions that outline the obligations of the franchisor and franchisee, covering aspects such as the supply of goods, operational support, marketing efforts, and compliance with established quality standards.²⁸⁶

Significantly, European Union legal practices emphasize the principle of shared responsibility between franchisors and franchisees toward end consumers. This may be connected to the nature of the franchise relationship, where both parties are jointly obligated to uphold consumer protection standards.

As the creator and provider of the business model and often the producer of goods or services, the franchisor bears substantial accountability for ensuring that the products or services marketed and sold under the franchise meet the promised quality, safety, and performance standards for consumers.²⁸⁷

²⁸⁴ Directive 2011/7/EU On Combating Late Payment in Commercial Transactions.

²⁸⁵ European Code of Ethics for Franchising, 1972, Art 2.2.i., and Commission Regulation, 4087/88 of 1988 on the application of Article 85 (3) of the Treaty to Categories of Franchise Agreements, (9).

²⁸⁶ Rafał Mańko, Action for damages against the EU, 2018. "See", in [https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/630333/EPRS_BRI\(2018\)630333_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2018/630333/EPRS_BRI(2018)630333_EN.pdf)

²⁸⁷ Consumer Protection Measures. Articles 114 and 169 of the Treaty on the Functioning of the European Union, 2008.

However, I agree that member countries maintain considerable autonomy in developing their regulatory approaches to franchise contract requirements. For instance, I learned that some European countries implement specific rules governing issues of franchise contracts, such as non-compete clauses, regulations on the renewal or termination of agreements, and provisions establishing fair pricing or profit-sharing arrangements.²⁸⁸ Therefore, specific contractual restrictions on the franchisee necessary to protect know-how and goodwill and maintain the franchise network's common identity falls outside the European cartel prohibition.²⁸⁹

²⁸⁸ Arthur Hartkamp, Martijn Hesselink and Ewoud Hondius, *Towards a European Civil Code*, Wolters Kluwer Law International, 2010, 110.

²⁸⁹ Annette Kur, Thomas Dreier and Stefan Luginbuehl, *European Intellectual Property Law*, Edward Elgar Publishing, 2013, 528.

Chapter Conclusion

Franchising regulation is a complex and multifaceted field that extends beyond national legal frameworks, requiring arrangement with key international legal instruments. One of the primary challenges in developing a coherent regulatory framework is validating consistency across different legal regimes. Despite variations in legal systems, countries strive to establish common standards through mutually accepted norms, reflecting the growing need for harmonization in franchise regulation.

The chapter analyzes key international documents, particularly European Union principles and directives, to highlight the role of international legal instruments in influencing national regulatory approaches. The study further demonstrates that while national laws provide the foundation for franchise regulation, a unified regulatory framework such as model laws enhances legal certainty and facilitates cross-border franchising.

The chapter contributes to the ongoing discussion on franchise regulation by identifying best practices and assessing how international legal frameworks can inform Mongolia's approach to franchising. The comparative analysis is a foundation for further research, emphasizing the need for a more structured and harmonized regulatory environment that supports franchisors and franchisees.

Chapter 6. Comparative Franchising Issues: Regulatory Framework and Case Studies

The free access jurisdiction chapters (except that of Spain and Australia) of the *Franchise Laws and Regulations Report – 2025* elaborated by the experts of *International Comparative Legal Guides* (ICLG) were very useful to control and actualize my previously developed texts below on the national laws' issues regarding franchise.²⁹⁰

Part 1. Civil Law Countries

1.1. Germany

The Scope of the Franchise Agreement

German law does not explicitly regulate franchising as a distinct contract type. Instead, franchise agreements are governed by general contract law under the German Civil Code (BGB) and relevant commercial laws. Franchise agreements in Germany function as mixed contracts, incorporating elements of sales (Articles 433-453) when the franchisor supplies goods, service (Articles 611-630) when the franchisor provides training or support, and agency (Articles 675, 677-687) when the franchisee acts as an intermediary. Furthermore, without a dedicated franchise disclosure law, German courts enforce disclosure obligations on franchisors through the principles of good faith (Article 242) and pre-contractual duties (Article 311), demonstrating the judiciary's role in compensating for regulatory gaps in franchise law.²⁹¹

Under German contract law, obligations are systematically classified into primary and secondary ones, a distinction fundamental to understanding the rights and duties arising from contractual relationships. Primary obligations constitute the main duties that form the essence of the agreement.

These obligations are directly tied to the purpose of the contract and represent the principal performances expected from the parties involved. For instance, in a franchise contract, the franchisor's primary obligations typically include granting the franchisee the right to use the franchisor's trademark and business model and providing ongoing support such as training, marketing assistance, and operational guidance. Conversely, the franchisee's primary obligations involve paying franchise fees, attaching to the franchisor's operational standards, and maintaining the brand's reputation.²⁹²

In contrast, secondary obligations are ancillary duties that arise to facilitate or support the fulfillment of the primary obligations. These often relate to maintaining good faith and

²⁹⁰ Iain Bowler ed., *Franchise Laws and Regulations Report 2025*. in <https://iclg.com/practice-areas/franchise-laws-and-regulations>

²⁹¹ Details see Marco Hero, Germany, in Iain Bowler ed., *Franchise Laws and Regulations Report 2025*.
Published free access at ICLG site: <https://iclg.com/practice-areas/franchise-laws-and-regulations>

²⁹² BGB, Contract Duty. Section 241 (1).

cooperation between the parties and may include duties such as providing contractual performance or avoiding harm to the other party during the execution of the agreement. Although they are supplementary, secondary obligations contribute to the adequate performance of the contract as a whole.²⁹³

Under German law, the legal consequences of breaching these two obligations differ significantly. A breach of primary obligations is considered a fundamental failure to fulfill the core purpose of the contract, and typically, the non-breaching party is granted the right to terminate the agreement. Such termination works as a remedy to restore the balance of the contractual relationship and allows the aggrieved party to seek alternatives.

On the other hand, a breach of secondary obligations generally does not justify the termination of the contract. Instead, such breaches are addressed through a claim for damages to compensate the aggrieved party for the harm caused by the non-performance or inadequate performance of these ancillary duties.²⁹⁴

In contrast to other jurisdictions, German law imposes a general duty of information during the pre-contractual phase based on contract law principles. Specifically, pre-contractual disclosure obligations arise from the principle of fault in the conclusion of a contract, as codified in Article 311(2) of the German Civil Code. The principle establishes a legal obligation for parties to act in good faith and disclose material information necessary for informed decision-making during contract negotiations.

Additional formal requirements may apply to franchise agreements, mainly when they include pre-emptive rights for acquiring real estate or shares in a GmbH (a German limited liability company). In such cases, the franchise agreement must be executed in a notarial deed under German law. The notary's role in this context is not merely procedural but substantive. Before notarizing the deed, notaries review the relevant provisions of the agreement to confirm compliance with German laws. They act as impartial legal professionals who supervise the contractual process and safeguard the interests of both parties.²⁹⁵

An interesting aspect of this approach is that, unlike jurisdictions that require the disclosure of a specific list of documents before signing a franchise agreement, it may rely on the notarization process to oversee the adequacy and legality of pre-contractual disclosures. This suggests that notaries play a supervisory role during the pre-contract stage, effectively acting as gatekeepers to certify that all legal requirements are satisfied.

²⁹³ *Ibid.*, Articles 433 (2); 611 (1).

²⁹⁴ *Ibid.* Damages for Breach of Duty. Section 280.

²⁹⁵ Reiner Schulze, Fryderyk Zoll, *The Law of Obligations in Europe*, Sellier European Law Publishers, 2013, 174.

While German law or court interpretations may not explicitly and uniformly outline these criteria, it is reasonable to infer that notaries rely on established legal principles, case law, and professional guidelines to assess compliance.²⁹⁶

Although German law does not explicitly define franchise agreements, it considers them arrangements where a franchisor grants the right to use its name or trademark as part of a marketing concept. Therefore, the German legal framework aims to protect franchisees from undue pressure or coercion that could exploit their position in the market. For instance, Germany's competition law explicitly addresses unfair business practices, including exploitive franchises. Such is particularly relevant in franchise agreements, where franchisors may have substantial power over franchisees.²⁹⁷ Beyond that, franchisors have various options for registering trademarks to safeguard their brand and intellectual property. They can register their trademarks as domestic, European Union, or international registrations. Each option provides different levels of protection and coverage.²⁹⁸

Pre-contractual Disclosure Obligation

In cases where a franchisor's lack of transparency or misrepresentation has caused pecuniary damages to a franchisee, courts usually order various forms of relief to compensate the franchisee for their losses. For instance, German courts have stressed that a franchisee should obtain information on its initiative about the general market conditions and their impact on the prospective franchised business. It reflects the expectation that franchisees should conduct due diligence and assess the viability of the franchise opportunity before entering into a franchise agreement.²⁹⁹ Therefore, German courts expect franchisees to exercise reasonable care and diligence in evaluating the franchise opportunity. While franchisors are typically responsible for providing specific information about the franchise system, German courts recognize that franchisees are also responsible for gathering information independently.³⁰⁰

Regarding legal disputes, the franchisor and franchisee may agree to seek arbitration to resolve contractual obligations. The German Civil Procedure law governs arbitration proceedings. The law provides a legal framework for parties to submit disputes to court or arbitration and certifies the enforceability of arbitration agreements.³⁰¹

²⁹⁶ Ned Levitt, Kendal Tyre, & Penny Ward, *Controlling Your International Franchising System*, ABA, 2010, 21.

²⁹⁷ Communication from the Commission: Guidelines on Vertical Restraints, European Commission, 2022, 3-102.

²⁹⁸ Lavinia Brancusi, *EU Trademark Law and Product Protection*, Routledge, 2024, 39.

²⁹⁹ Levitt, Tyre and Ward (2010) 21.

³⁰⁰ Robert Smith, Tom Billing, *Franchising in Germany*. Franchise Law Insider, 2019, "See", in <https://franchiseinsider.quarles.com/2019/09/franchising-in-germany/>

³⁰¹ Section 1029-1033, German Arbitration Law 98.

CASE LAW

1. Performance of Pre-Contractual Obligations

Court: Darmstadt Regional Court; Higher Regional Court, Germany

Facts of the Case

In 2015, the plaintiff, a franchisee, approached the defendant, a franchisor operating a cosmetic studio franchise system, expressing interest in joining the franchise. At the outset, the franchisor provided the franchisee with a company brochure, which included general information about the franchise system, certified by a notary.

The franchisor sent the franchisee an additional information brochure for prospective franchisees and a location assessment to evaluate the business's potential.

The franchisee subsequently engaged a consultancy firm to develop a business plan, using the information provided by the franchisor to guide the franchise's launch. However, the franchisee's business venture was unsuccessful, leading her to allege that the franchisor had provided incomplete and misleading information during the pre-contractual phase, constituting fraudulent misrepresentation. As a result, the franchisee sought to annul the franchise agreement.

Legal Issues

Whether the franchisor engaged in fraudulent misrepresentation during the pre-contractual phase, warranting the cancellation of the franchise agreement.

Court Decision/Ruling

The Darmstadt Regional Court ruled in favor of the franchisor, holding that the franchisor had fulfilled its pre-contractual duty to inform the franchisee.

The court determined that the information provided to the franchisee, including the initial brochure and subsequent materials, contained all the necessary details for making an informed decision. The court also found that any inaccuracies in the business plan, developed by a consultancy firm independently hired by the franchisee, were not the franchisor's responsibility.

The Higher Regional Court upheld the decision, affirming that the franchisor was not liable for any alleged misrepresentations in the business plan, as the consultancy firm had acted independently and was commissioned by the franchisee. The court concluded that the franchisor had met its obligations and had not engaged in fraudulent misrepresentation.

Conclusion

The franchisee's claims of fraudulent misrepresentation were rejected, and the court affirmed the validity of the franchise agreement.

The franchisor was found to have provided adequate information during the pre-contractual phase and was not liable for the franchisee's business failure.³⁰²

2. Subway Franchise Case Summary

Court: Higher Regional Court of Dresden, Germany

Facts of the Case

A franchise agreement was entered between Subway, a U.S.-based fast-food franchisor, and a German franchisee, permitting the franchisee to operate a branch in Germany. The agreement was based on the franchisor's standard contract template and was governed by the laws of Liechtenstein. It contained arbitration clauses stipulating dispute resolution under the United Nations Commission on International Trade Law Rules. A dispute arose between the parties, leading the franchisor to initiate arbitration proceedings through the American Dispute Resolution Center in Glastonbury, New York. The arbitrator ruled in favor of the franchisor. Subsequently, the franchisor sought enforcement of the arbitral award in Germany.

Procedural History

The franchisee challenged the enforcement of the arbitral award before the Higher Regional Court of Dresden. The franchisee contended that the arbitration clauses were invalid and that its counterclaims should be admissible before German courts.

Legal Issues

Whether the arbitration clauses in the franchise agreement were valid under German law.

Whether the franchisee's counterclaims were admissible despite the arbitration agreement.

Court Decision/Holding

The Higher Regional Court of Dresden upheld the validity of all three arbitration clauses in the franchise agreement and ruled that the franchisee's counterclaims were inadmissible. It applied an analogy to Article 1032(1) of the German Civil Procedure Code, which governs the admissibility of claims in arbitration.

Reasoning

The court found that the arbitration clauses were binding and enforceable under international arbitration standards. Enforcing the arbitral award did not violate the law.

The franchisee had contractually consented to arbitration under UNCITRAL rules, which limited its ability to pursue claims in German courts.

³⁰² Darmstadt Regional Court, Judgment of 25 November 2020-9 O 198/18, Hamburg Higher Regional Court, Judgement of 25 February 2022 - 1 U 104/19. "See", in <https://www.noerr.com/en/insights/new-decision-on-franchise-law-by-the-higher-regional-court-frankfurt-am>

Significance

The case underscores the importance of international arbitration in franchise dispute resolution. The decision highlights the franchisor's control over the dispute resolution process and the potential power imbalance in franchise agreements. It also reinforces the binding nature of arbitration clauses in cross-border franchise contracts, affecting how franchisees can challenge arbitral awards in domestic courts.³⁰³

3. Franchisee v. Franchisor

Court

Higher Regional Court of Düsseldorf (OLG Düsseldorf), Germany

Facts of the Case

The claimant, a franchisee, sought to nullify the agreement, alleging that the franchisor had provided misleading information during the pre-contractual stage. The franchisee asserted that the franchisor had assured him of maintaining business relationships with several key customers, allowing the franchisee to generate significant economic benefits.

Additionally, the franchisor projected an expected turnover of €33,000 for the first four months of operation. However, after signing the agreement, the franchisee generated only €1,500 during the same period- substantially lower than anticipated.

Procedural History

The franchisee initiated legal proceedings before the Higher Regional Court of Düsseldorf (OLG Düsseldorf), arguing that the franchisor's misrepresentations justified the nullification of the franchise agreement. The court examined the extent of the franchisor's pre-contractual disclosure obligations and the legal consequences of providing inaccurate financial projections.

Legal Issue

Did the franchisor's pre-contractual representations amount to misleading or inaccurate information, justifying nullification of the franchise agreement?

What are the franchisor's legal obligations regarding pre-contractual disclosure in franchise agreements?

Court Decision/Holding

The Higher Regional Court of Düsseldorf ruled that the franchisor had a duty to provide accurate and comprehensive information before concluding the franchise agreement. The court emphasized that pre-contractual disclosure obligations are fundamental to fair business practices.

³⁰³ Oberlandesgericht Dresden/11 Sch 08/07 2007, Germany. "See", in https://newyorkconvention1958.org/index.php?lvl=concept_see&id=66&page=57&nbr_lignes=2124&l_typo=c=

Reasoning

The court reaffirmed that franchisees rely heavily on the accuracy of pre-contractual information when making investment decisions. The franchisor's turnover projection of €33,000 was found to be unrealistic and misleading, as the franchisee's actual revenue fell drastically short of expectations. The court determined that pre-contractual misrepresentations, even without direct damages, could justify legal recourse for franchisees.³⁰⁴

Significance

The case underscores the role of pre-contractual disclosure obligations in franchise agreements. It reinforces that franchisors must provide accurate and sufficient information and that misleading representations can have serious legal and financial consequences. The court's approach also indicates that legal recourse is available for franchisees even when no direct financial damage has occurred, highlighting the importance of fair and transparent franchise practices.³⁰⁵

³⁰⁴ OLG Düsseldorf GER, Urteil vom 25.10.2013- Az. 1-22 U 62/13. "See", in <https://www.evers-vertriebsrecht.de/mandanten/franchisenehmer/>

³⁰⁵ Dagmar Waldzus, *Germany-Pre-Contractual Disclosure Requirements and Relevant Case Law*, International Journal of Franchising Law, 2014, Volume 12, 3-10.

1.2. Italy

Italy's franchising framework is primarily governed by the 2004 Franchise Law and Contract Law Articles of 1321-1469, which establishes core requirements for franchise agreements, outlines franchisees' obligations, and details specific provisions related to contract termination.³⁰⁶ The legislation promoted balance in franchise relationships, providing a clear legal structure to protect the interests of both franchisors and franchisees. In addition, the Italian government enacted a 2005 decree that further clarifies and extends the rights and protections available to franchisees. Notably, this decree applies to franchisors operating beyond Italian borders.³⁰⁷

These legal acts emphasize the commitment to encouraging a balanced franchising environment. For example, the franchise agreement must be at least three years unless both parties mutually agree to a shorter term based on valid and justifiable reasons. Moreover, the contract must be formalized in writing to enhance legal clarity and establish a definitive record of the franchisors' and franchisee's rights, responsibilities, and obligations. According to the 2004 law, the agreement must clearly outline the franchisee's financial commitments, including initial fees or investments required to join the franchise network. If territorial exclusivity is included in the arrangement, it must be explicitly detailed in the contract.

I agree that such a legal framework reflects the country's commitment to promoting professionalism in franchising. In particular, it establishes a minimum agreement duration and a detailed disclosure of financial and operational terms; the law is rigid. However, the law could create obstacles for small businesses seeking to expand.³⁰⁸ Italian franchise legislation provides detailed regulations regarding the conditions to be imposed during the pre-franchise phase of the contract. According to the Italian Franchise Act, a franchisor must supply information to the franchisee at least 30 days before the established agreement, primarily relating to the pursuit of business within Italy. Franchise law outlines the following requirements for open documents:³⁰⁹

- The legal name of the franchisor, along with details about the company's assets and financial statements for the past three years, must be provided. If the franchisor has been in operation for less than three years, it supplies financial statements from its establishment upon the franchisee's request.
- A concise description of the business purpose, including a detailed list of activities carried out by stakeholders within the franchise system, is required. Furthermore, information regarding trademark registration, deposit status, or any permissions granted by third parties to the franchisee should be disclosed.
- The franchisor must include these terms and conditions in the required disclosure documents.

³⁰⁶ Details see Luigi Fontanesi et al., Italy, in Iain Bowler ed., *Franchise Laws and Regulations Report 2025*.
Published free access at ICLG site: <https://iclg.com/practice-areas/franchise-laws-and-regulations>

³⁰⁷ Decree n.204/2005.

³⁰⁸ Italian Franchise Law n.129/2004

³⁰⁹ *Ibid.*

This obligation confirms that franchisees have the necessary information to assess the business opportunity and meet the associated requirements.

The resolution of franchise disputes is governed by a combination of contract law, arbitration law, and civil procedure rules, with specific regulations applicable to franchising. Code of Civil Procedure regulates litigation procedures in ordinary courts when franchise disputes are brought before them. Jurisdiction and choice of court clauses in franchise agreements must comply with Civil procedure rules. Arbitration is not mandatory in Italian franchise agreements. However, Italian law allows parties to include arbitration clauses in franchise agreements, provided they meet legal requirements.

Short Case Summary: *Punto Telefonia S.n.c. v. Wind Telecomunicazioni S.p.a.*

Court: Tribunal of Rome

Legal Issue

Enforceability of an arbitration clause in a franchise agreement

Facts of the Case

Punto Telefonia S.n.c. (franchisee) failed to pay multiple invoices for goods supplied by Wind Telecomunicazioni S.p.a. (franchisor).

The franchisor sought and obtained a payment injunction against the franchisee. In response, the franchisee challenged the injunction before the Tribunal of Rome, arguing that the franchisor was precluded from seeking relief in court due to the arbitration clause in the franchise agreement.

Holding

The Tribunal of Rome ruled that the arbitration clause was non-binding, allowing the parties to pursue either arbitration or litigation in ordinary courts.

Reasoning

The Tribunal's decision did not provide a detailed rationale, which raises legal concerns. Arbitration clauses generally exclude national courts' jurisdiction, ensuring a specialized and neutral dispute resolution forum. By deeming the clause non-binding and allowing parties to choose between arbitration or court proceedings, the ruling potentially undermines the enforceability of arbitration agreements and introduces legal uncertainty.

Significance

The Tribunal's ruling may challenge the fundamental purpose of arbitration clauses, which provide a binding alternative to litigation. The decision could have broader implications for contract enforcement and arbitration in franchise agreements, particularly in jurisdictions that

emphasize the strict enforcement of such clauses.³¹⁰

1.3. France

The French Civil Code does not explicitly regulate franchising as a distinct legal concept.³¹¹ However, elements of franchising are governed by a combination of French contract law, commercial law, and specific regulations aimed at franchise relationships. For instance, the Civil Code outlines the legal framework for franchise agreements, defining contracts as agreements that create or modify obligations while mandating good faith and loyalty between parties.

According to French law, a party's failure to meet its contractual obligations can lead to the termination of the contract, a principle outlined in the French Civil Code. Specifically, Article 1224 addresses contract termination due to non-performance, permitting dissolution of a contract if a court finds one party's breach of obligations sufficiently serious.³¹²

In addition to contract law regulation, French franchising is governed by the *Loi Doubin*, which requires stringent pre-contractual disclosure requirements. According to law, if the franchisor does not provide complete or accurate information during the pre-contractual phase, it can be considered a breach of disclosure requirements. In other words, Failure to comply with legal obligations can have serious repercussions for franchisors, including the annulment of the franchise agreement or compensation claims from the franchisee.

That is why this approach, incorporating general contract law principles from the French Civil Code and specific franchisee protections under the *Loi Doubin*, illustrates France's comprehensive regulatory framework for franchise agreements. By combining distinct legal elements, French law may establish the enforcement of contractual obligations and protect franchisees, ultimately encouraging a transparent franchise system. In other words, French law provides a comprehensive regulatory framework for franchise agreements based on an analysis of the general principles of contract law and the specific franchising provisions.³¹³

French law validates that parties are held accountable for fulfilling their contractual commitments, thereby maintaining the integrity of contractual relationships. On the other hand, it offers protections for franchisees, mainly through mechanisms such as the *Loi Doubin*, which requires complete and accurate pre-contractual disclosure.³¹⁴

The *Loi Doubin* Law provides a consumer protection measure by requiring franchisors to provide potential franchisees with a disclosure document. The law primarily seeks to reduce information

³¹⁰ Tribunal of Roma, March 17, 2012-Punto telefonia s.n.c. v. Wind telecomunicazioni S.p.A., "See", in <https://www.idiproject.com/news/italy-italian-case-law-distribution-and-franchise-contracts/>

³¹¹ Details see Cecile Peskine et al., France, in Iain Bowler ed., *Franchise Laws and Regulations Report 2025*. Published free access at ICLG site: <https://iclg.com/practice-areas/franchise-laws-and-regulations>

³¹² French Civil Code, Article 1224.

³¹³ *Ibid*, Paragraph of the Effects of Indivisible Obligations, Articles 1222 to 1225; *Loi Doubin* Law No. 89-1008 of December 31, 1989.

³¹⁴ Atwell (2019) 439-467.

asymmetry between franchisors and franchisees, maintaining that franchisees fully understand the financial and operational commitments.

According to this law, franchisors must supply franchisees with disclosure documents at least 20 days before signing a franchise agreement and at least 20 days before making any payment or investment.³¹⁵

Franchisors must inform the social dialogue committee of decisions likely to affect the volume or structure of the workforce. Concerning courts may “rebalance” the terms of franchise agreements or remove a term that creates an imbalance in contracts. Hence, the French courts usually emphasize the significance of know-how and ongoing technical support as criteria distinguishing franchising from other distribution systems.³¹⁶

Regarding franchise contracts, where the franchisor and franchisee are often in an imbalanced power, franchise laws provide protections to the franchisee, which courts assess whether the breach significantly undermines the franchise agreement, such as failure to meet performance standards, provide required support or uphold contractual obligations.³¹⁷

Article L. 442-1, I, 2° of the French Commercial Code regulates significant imbalances in commercial contracts, including franchise agreements. This provision protects economically weaker parties, such as franchisees, from unfair contractual terms imposed by stronger parties, such as franchisors or dominant businesses. According to the law, if a franchise agreement includes clauses that create a significant imbalance, the courts may declare them void, impose fines or damages on the franchisor, and allow legal action by the French Minister of the Economy or an aggrieved party, particularly in cases involving unilateral termination, excessive supply restrictions, or limitations on contract transferability.

Short Case Summary: *French Minister for Economic Affairs v. Subway*

Court: Paris Commercial Court

Legal Issue

Assessment of significant imbalance in the rights and obligations of parties within Subway’s franchise agreements, under Article L. 442-6, I, 2° of the French Commercial Code.

Significant Imbalance in Franchise Agreements.

Facts of the Case

The French Minister for Economic Affairs initiated legal proceedings against Subway, alleging that specific clauses in Subway’s franchise agreements created a significant imbalance between

³¹⁵ The French Commercial Code Article L. 330-3, L. 442-1, I, 2°; The French Civil Code, Article 1112-1.

³¹⁶ Courtenay Atwell, *Franchising in France: An Overview*, European Business Law Review, 2019, Volume 30, 439-467.

³¹⁷ Zimmermann, Whittaker (2000) 695.

the franchisor and franchisees. The contested clauses pertained to various aspects of the franchise relationship, including termination conditions, supply obligations, and territorial restrictions.

Decision

The Paris Commercial Court ruled in favor of the French Minister for Economic Affairs, finding that the disputed clauses in Subway's franchise agreements created a significant imbalance in the parties' rights and obligations. Consequently, the court annulled the problematic provisions, emphasizing the necessity for fairness and equilibrium in franchise contracts.

Significance

This decision underscores the French judiciary's commitment to ensuring equitable franchise relationships by scrutinizing contractual terms that may disproportionately favor franchisors. It highlights the importance for franchisors operating in France to carefully draft their agreements, ensuring compliance with Article L. 442-6, I, 2° of the French Commercial Code, which prohibits significant imbalances in contractual obligations.³¹⁸

1.4. Spain

Franchising in Spain is primarily governed by the general contract law provisions within the Spanish Civil Code, which apply to franchise agreements like other commercial contracts. While the Civil Code does not explicitly address franchising, key issues concerning contract formation, performance, good faith, and breach provide the legal framework for franchise relationships.³¹⁹

By merging these principles, the Spanish Civil Code probably aims to balance franchisors' interests while upholding broader policy objectives of transparency and accountability in commercial transactions.³²⁰

Franchise Law in Spain, enacted in 1996, establishes a legal framework that regulates franchising in the country. It aims to balance the interests of franchisors and franchisees while ensuring transparency and fairness in franchise relationships.

The law requires franchisors to provide prospective franchisees with essential information through a comprehensive Disclosure Document at least 20 days before the signing of a franchise agreement.

The document must include details about the franchise system, financial performance, training and support, and the terms of the agreement, allowing the franchisee to make an informed decision.³²¹

³¹⁸ Court of Appeal of Paris, 2021. "See," in <https://www.idiproject.com/news/france-comments-ruling-issued-paris-commercial-court-against-subway-cancelling-clauses/>

³¹⁹ Spanish Civil Code, Articles 1254, 1261, 1277.

³²⁰ *Ibid*, Articles 1134, 1258.

³²¹ The Ley de Franquicia (Law 34/1996).

The law also mandates that the franchise agreement be clearly defined, specifying essential elements such as contract duration, termination and renewal conditions, and the franchisee's rights and territorial exclusivity.

Additionally, when foreign franchisors are involved, the franchise agreement must be registered with the General Directorate for Trade and Consumption, establishing legal recognition and obedience to Spanish regulations.

The Ley de Franquicia also offers legal protection to franchisees, requiring franchisors to provide necessary support and training and protecting them from unfair terminations or unreasonable changes to contract terms. The law also regulates competition, preventing the imposition of excessive non-compete clauses and encouraging good-faith negotiations.³²²

Short Case Summary: *Clínica Renacimiento v. Their Employees*

Court: High Court of Appeal of Málaga

Legal Issue

Liability of Franchisor for Franchisee's Actions. Determination of franchisor liability for the actions of its franchisee in a cosmetic surgery context.

Facts of the Case

A patient underwent two liposuction procedures at a clinic operating under the franchise "Clínica Renacimiento." The outcomes were unsatisfactory, leading the patient to file a civil lawsuit against the franchisee (the clinic), the franchisor (Clínica Renacimiento), and the associated insurance company.

Decision

The High Court of Appeal of Málaga held the franchisor, Clínica Renacimiento, liable for its franchisees and their employees' actions. The court determined that the franchisor bore responsibility for the malpractice at the franchisee's clinic.

Significance

The ruling underscores the potential for franchisors in Spain to be held accountable for the actions of their franchisees, particularly in sectors like healthcare, where service quality and professional conduct are critical. It highlights franchisors' importance in implementing stringent oversight and quality control measures within their franchise networks. The case also establishes a significant precedent in Spanish franchise law, particularly concerning franchisors' liability for their franchisees' actions.³²³

³²² Jaume Martí Miravalls, *Spanish Legal System on Disclosure in Franchise Network*, European Business Law Review, 2014, Volume 25, 943-955.

³²³ <https://www.fieldfisher.com/en/services/franchising/franchise-commercial-law-blog/update-from-spain-franchisors-found-liable-for-the-acts-of-their-franchisees>

Part 2. Common Law Countries

2.1. Canada

Canadian franchise laws include several provisions to prevent parties from circumventing the legislative framework.³²⁴ Any waivers or releases that attempt to forfeit a franchisee's statutory rights are considered void. Similarly, contractual clauses that attempt to alter the governing law of the franchise agreement or designate a dispute resolution venue outside of the jurisdiction where the franchise operates are also unenforceable. Canadian British Columbia disclosure law and Arthur Wishart Act have a similar content of disclosure documents to U.S FDD.³²⁵

According to Canadian law, the franchisor must provide the disclosure document at least 14 days before signing the agreement. The document includes a non-disclosure clause and a contract specifying the area of operations. The franchisee partner is also required to pay fees set by the franchisor. However, the franchise fee does not exceed 20 percent of the total cost. The franchise disclosure document should encompass all the facts necessary for the franchisee to decide whether to purchase the franchise. The parties in the franchise agreement are obligated to act in good faith under the legal provisions while exercising their contract rights.³²⁶

The franchise agreement prohibits the parties from waiving their rights or obligations under the franchise rules. Suppose the documents are incomplete or do not meet the legal requirements. In that case, the franchisor has the right to terminate the agreement without incurring any obligations or penalties for two years if the disclosure document is not provided within 60 days of receiving the documents after the conclusion of the contract.

The franchisor is prohibited from interfering with the franchisee and their partner in establishing an association or relationship with other organizations under the franchise agreement. If the franchisee purchases the franchise while knowing that the information is false, the disclosure document is deemed to have been obtained without the franchisor's knowledge; after the document is provided, the franchisee must review it before purchasing the franchise. In the event of termination of the agreement due to the franchisee's fault, the franchisor must compensate for the net loss incurred during the operation within 30 days of receiving the notice of termination.³²⁷

Key elements of Canadian franchise agreements typically include fees and additional costs, late payment terms, usage of intellectual property rights, conditions for renewal and termination, and territorial clauses. The contract will specify how these regulations are to be used.³²⁸

³²⁴ Details see Joseph Adler et al., Canada, in Iain Bowler ed., *Franchise Laws and Regulations Report 2025*.
Published free access at ICLG site: <https://iclg.com/practice-areas/franchise-laws-and-regulations>

³²⁵ Evan Thomas, *Recent Developments in Canadian Franchise Class Action*, *Franchise Law Journal*, 2016, Volume 35, 399-420.

³²⁶ Zeidman (2014) 35-77.

³²⁷ The Amendment to the Arthur Wishart Act and Its General Regulation, S.O. 2000, Chapter 3, Sections 5-12.

³²⁸ British Columbia Franchise Act, Chapter 35, 2017, CAN.

The franchisor outlines the training to be conducted and the franchisee's responsibilities. The franchisor will also discuss the franchise business's requirements and limitations.

The franchisor will specify the conditions under which the franchisee may terminate the franchise due to poor performance or other reasons and clarify whether the franchisee has any remedies for any breaches. These steps typically include returning confidential materials, ceasing to use intellectual property, and paying outstanding fees.

Additionally, a non-competition period may be established during which the terminated franchisee is prohibited from working with the specified companies for a set duration. Franchise laws state whether the franchisee has a designated territory and if they have the right to open a branch near another franchisee. If the franchisee does not have sufficient insurance, the franchisor may obtain insurance on their behalf and seek reimbursement from the franchisee. Under British Columbia's Disclosure Law and the Law and Equity Act, the franchisee must compensate for any actions that negatively impact the franchisor's brand.³²⁹

In the context of franchising, the Canadian Trade Marks Act defines a trademark as a mark a person uses to distinguish their goods or services from those of others. For a trademark to function effectively in a franchise, it must be distinctive, allowing it to differentiate the franchisor's goods or services from those of competitors.³³⁰

Arthur Wishart Act

Canadian franchise law, particularly as outlined in provincial statutes like Ontario's Arthur Wishart Act and similar legislation across other provinces, mandates franchisors to disclose comprehensive information to franchisees. When entering an agreement, franchisees often invest significant time, money, and resources. Therefore, disclosure establishes that they have access to accurate and pertinent facts about the franchisor, the franchise system, financial risks, and other vital factors, allowing them to make informed decisions before signing a franchise agreement.

The Arthur Wishart Act of Canada, enacted in 2000, governs the franchise disclosure relationship. Amendments made up to 2020 addressed the requirements for franchise agreements, reflecting the challenges posed by recent franchising issues. The act oversees franchise communication in Ontario, emphasizing the protection of franchisees by imposing specific obligations on franchisors. Specifically, Chapter 3 defines a franchise as a binding agreement through which the franchisee agrees to pay initial and recurring fees for the right to use intellectual property, including trademarks and trade names.³³¹

After reviewing the Act, I learned the following points. First, the franchisor supports the business; the franchisee grants the right to control. Such contribution can be seen as a model of

³²⁹ *Ibid.*

³³⁰ Trademarks Act of 1985, R.S.C. T-13, Canada.

³³¹ Arthur Wishart Act, 2000, Last Amendment 2017, Chapter 3.

infrastructure for conducting trade and services, financial calculations, location selection, marketing techniques, training, and product supply.

Second, the amendments to the Act emphasize the assistance or supervision that a third party approved by the franchisor may offer. Thus, the franchise agreement is an important commercial document introducing industrial property into the economic flow through bilateral cooperation.

Due to the Act, a franchise agreement typically involves a complex relationship among multiple parties, such as the subfranchisor and subfranchisee, rather than a simple dealership setup. It reflects the essence of a franchise as an integrated system that extends beyond product distribution to include intellectual property, branding, and operational methods. Conversely, the definition of the franchisor as having the right to directly or indirectly control the franchisee's business based on the agreement is considered ambiguous. Although the franchisor's direct and advisory control, or supervision, is expressed in the general context of the Act, it may be necessary to clarify more precise definitions.

The Act includes sections on material changes and facts that are mandatory to regulate or reflect within the franchise agreement. These can be viewed as detailed matters that the parties agree to and disclose to one another in any form. For example, the definition of material facts encompasses information about business operations, assets, partners, and the franchise system. A false or incomplete statement of a material fact will be regarded as a "misrepresentation."

The Act recognizes that the franchisor (or its associates) may be formed as a corporation, thus necessitating regulations regarding corporate control. A person is deemed to control the franchisee or the franchisor's associate if they possess more than 50 percent of the voting securities. The control includes the ability to elect the majority of the board of directors, a crucial mechanism for overseeing the franchisor's operations and strategic decisions. By clarifying when a franchisor or associate is under the control of another entity, the Act certifies that franchisees are informed of who ultimately holds decision-making authority in franchise management. These patterns were termed core elements of "Deemed Control" by the Arthur Wishart Act.³³²

The purpose of deemed control appears to confirm transparency in franchises by identifying situations where a party effectively controls a franchise entity. Deemed control addresses potential concerns about indirect influence, establishing that franchisees know who controls the franchisor or its associates.

Additionally, disclosure obligations under the Act appropriately account for such control. For example, franchisors and their associates are supposed to disclose their ownership and control structures. Consequently, franchisees can better understand the leading entities in franchising, which may impact their business.³³³

³³² Richard Leblanc, Debi Sutin, *The Arthur Wishart Act -An Overview*, 2012, Ontario Bar Association, 14.

³³³ Arthur Wishart Act, Amendment 2017, c. 20, Sched. 9, s. 1 (1-3)-14/11/2017.

Such a provision reinforces accountability in franchise agreements, supporting the legal instruments' broader goal of protecting franchisees from exploitation.

Another notable issue is that the Arthur Wishart Act does not apply to arrangements involving employer-employee relationships, partnerships, or membership in a cooperative association, as outlined. Specifically, the Act does not cover agreements permitting trademarks, logos, or other commercial symbols to provide evaluation, testing, or certification services.

These arrangements typically do not create a comprehensive franchise relationship. Instead, they focus on a specific function (e.g., product testing or quality certification) and lack the ongoing obligations or interdependence that define franchising.

Agreements between a licensor and a single licensee, such as those involving the use of intellectual property or a trademark, are excluded from the definition of a franchise under the Act. This is because arrangements are often more straightforward, granting a limited right to use intellectual property without the extensive obligations or controls in a franchise system, such as operational manuals, business systems, or royalties.

Based on these points, I would argue that the Act's applicability is evident in the following cases:

First, the Act applies to any franchise agreement entered into after the Act came into force, ensuring that all new franchise arrangements fulfill the obligations outlined in the Act, including disclosure requirements.

Second, the Act also applies to the renewal or extension of franchise agreements, regardless of whether the original deal was established before or after the Act's commencement. Finally, the Act emphasizes that each franchise agreement imposes an obligation on the parties to act reasonably in its implementation and guarantees the right of one party to the franchise agreement to sue for damages caused by the other party to the contract.³³⁴

Comparing this case study and the Arthur Wishart Act, A franchisee may rescind the franchise agreement within 60 days after receiving the disclosure document if the disclosure document was not provided on time as required by the Act and the statement of material change was not provided when needed. Such a precondition confirms that franchisees have adequate time to review all necessary information before committing fully to the franchise relationship.

Late or incomplete disclosure undermines contract parties' ability to make informed decisions. The agreement rescission framework aligns with the Act's overall purpose of protecting franchisees and encouraging transparency in franchising, making Ontario one of the more franchisee-friendly jurisdictions.

³³⁴ Bryan Schwartz, John Pozios and Leandro Zylberman, Response to Consultation Paper on Franchise Law, Underneath the Golden Boy, 296-351, "See", in https://themanitobalawjournal.com/wp-content/uploads/articles/UTGB_6/Response-to-Consultation-Paper-on-Franchise-Law.pdf

CASE LAW

1. Canada Inc. v. Dollar It Limited

Court: Court of Appeal (Ontario)

Legal Issue

Disclosure requirements, rescission rights, and franchisor obligations under the Arthur Wishart Act.

Facts of the Case

Canada Inc., a franchisee, sought to rescind its franchise agreement with Dollar It Limited, arguing that the franchisor failed to meet its disclosure obligations under the Arthur Wishart Act. The franchisee claimed that the disclosure document was materially deficient and lacked the essential information required by the Act.³³⁵

The deficiencies included the omission of financial statements, the absence of key facts about the franchise system, and the failure to disclose the franchisor's obligations and operational history. Due to these material omissions, the franchisee asserted its right to rescind the agreement within two years of signing.

Decision/Holding

The court ruled in favor of the franchisee, determining that Dollar It Limited had indeed provided an inadequate disclosure document. As a result, the franchisee was entitled to rescind the agreement within the statutory two-year period. The court ordered the franchisor to compensate the franchisee for all payments made under the franchise agreement, including additional losses incurred from entering the contract, such as operational costs.

Legal Principles

Importance of Proper Disclosure: The ruling reinforced the necessity of transparency in franchise relationships. The franchisor's failure to provide a complete and accurate disclosure document resulted in severe financial consequences.

Fair Dealing in Franchising: The case highlighted the principle of fair dealing, which is fundamental to franchise agreements and differentiates franchising from other business models that may exploit power asymmetries.

Franchisee's Right to Associate: Under the Arthur Wishart Act, franchisees are explicitly granted the right to form or join franchisee organizations. The court emphasized that franchisors cannot penalize or restrict franchisees from exercising this right.

³³⁵ Arthur Wishart Act, 2000, c. 3, s. 3 (3), 4 (1)- 4.5.

Liability for Non-Disclosure and Misrepresentation: If a franchisor fails to provide a disclosure document or submits a misleading or incomplete one, the franchisee has the right to rescind the agreement within two years. Furthermore, franchisors may be liable for damages resulting from non-disclosure or misrepresentation.

Requirement for Accuracy in Disclosure Documents: All information in a disclosure document, including material change statements, must be presented accurately, clearly, and concisely. Franchisees who suffer losses due to misrepresentation in such documents may seek damages against the franchisor and its agents.

Significance

The decision in *Canada Inc. v. Dollar It Limited* sets a strong precedent in Canadian franchise law, underscoring the importance of complete and accurate disclosure. The case reinforces franchisee protections against unfair practices under the Arthur Wishart Act. The ruling continues to shape franchise regulations in Canada, establishing that franchise agreements are entered into with complete transparency and fairness.³³⁶

2. Shelanu Inc. v. Print Three Franchising Corporation

Court: Ontario Court of Appeal

Legal Issue: Duty of fair dealing and good faith in franchise relationships under the Arthur Wishart Act

Facts of the Case

Shelanu Inc., a Print Three Franchising Corporation franchisee, alleged that the franchisor failed to provide adequate support as required by the franchise agreement. Shelanu claimed that Print Three acted in bad faith, violating its contractual obligations and the statutory duty of fair dealing imposed by the Arthur Wishart Act. The franchisee sought damages for financial losses from the franchisor's alleged misconduct.

Legal Issue

The trial court examined whether Print Three's actions constituted a breach of the statutory duty of fair dealing under the Arthur Wishart Act and the broader standard law duty of good faith. The trial judge ruled that, even if the statutory duty did not apply, the franchisor was still bound by a general duty of good faith, requiring it to act honestly and fairly in its dealings with the franchisee.

The court found that Print Three failed to fulfill its contractual obligations and engaged in conduct that undermined the franchisee's ability to benefit from the agreement.

³³⁶ Canada Inc. et al. v. Dollar It Ltd. et al., (2009) 250 O.A.C. 280 (CA). "See", in <https://ca.vlex.com/vid/6792341-can-v-dollar-681651713>

Decision/Holding

The Ontario Court of Appeal upheld the trial court's findings, reaffirming that the statutory duty of fair dealing under the Arthur Wishart Act sets a minimum standard for franchise relationships. The court confirmed that franchisors must act in good faith and accordance with franchisees' reasonable expectations.

Significance

This decision remains a leading case in Canadian franchise law, frequently cited in disputes involving allegations of unfair conduct by franchisors. Shelanu established a high standard for fair dealing and reinforced the importance of good faith in franchise agreements, shaping the legal framework for franchise relationships in Canada.³³⁷

3. *Sovereignty Investment Holdings, Inc. v. 9127-6907 Quebec Inc.*

Court: Ontario Court of Appeal

Legal Issue

Disclosure requirements, misrepresentation, and rescission of franchise agreements under the Arthur Wishart Act

Facts of the Case

Sovereignty Investment Holdings, Inc. (the franchisee) entered a franchise agreement with 9127-6907 Quebec Inc. (the franchisor). The franchisee later alleged that the franchisor failed to comply with the disclosure requirements mandated by the Arthur Wishart Act (Franchise Disclosure), 2000, and sought to rescind the agreement.

Under the Act, franchisors must provide prospective franchisees with a disclosure document containing all material facts and financial information at least 14 days before signing the franchise agreement. The Act also grants franchisees the right to rescind the contract within 60 days if the disclosure document is deficient or within two years if no document is provided.

Legal Issue

The court examined whether the franchisor provided complete and compliant disclosure as required by the Arthur Wishart Act. The franchisee argued that the disclosure was inadequate and that the franchisor's failure to disclose material facts amounted to misrepresentation, causing financial losses.

The court found that the franchisor had failed to meet its disclosure obligations by either providing an incomplete document or failing to deliver it entirely. As a result, the franchisee was entitled to rescind the agreement under the two-year rescission provision of the Act.

³³⁷ Shelanu Inc. v. Print Three Franchising, (2003) 172 O.A.C. 78 (CA). "See", in <https://ca.vlex.com/vid/shelanu-inc-v-print-681493737>

Decision

The court ruled in favor of the franchisee, confirming their right to rescind the agreement due to the franchisor's failure to disclose appropriately. The franchisor was ordered to compensate the franchisee for expenses incurred due to the non-compliance and misrepresentation.

Significance

This case reinforces the strict disclosure requirements under the Arthur Wishart Act and highlights the severe consequences for franchisors who fail to comply. It serves as a key precedent for franchisees seeking rescission due to inadequate disclosure and underscores the importance of transparency in franchise relationships.³³⁸

4. *Ontario Inc. (c.o.b. Jayasena Management Corp.) v. Savannah Wells Holdings Inc.*

Court: Ontario Court of Appeal

Legal Issue

Statutory exemptions related to the franchisor's obligation to provide a franchise disclosure document under the Arthur Wishart Act, 2000

Facts of the Case

The plaintiff, Ontario Inc. (c.o.b. Jayasena Management Corp.), acquired an existing franchise from the original franchisee with the approval of the defendant franchisor, Savannah Wells Holdings Inc. The franchisees sought a declaration under the Arthur Wishart Act that they had adequately rescinded their agreements due to insufficient disclosure. They also pursued damages from the franchisor and its alleged associates. The key issue was whether the franchisor actively granted the franchise or provided passive consent to transferring an existing franchise.

Legal Issues

Under the Arthur Wishart Act, franchisors must provide franchise disclosure documents unless specific statutory exemptions apply. The court examined whether the franchisor's involvement in the franchise transfer constituted a new franchise grant requiring disclosure. If the franchisor significantly influenced or carried out the franchise grant, it would be obligated to provide disclosure documents. The court found that the franchisor actively facilitated the new franchise agreement rather than merely consenting to the transfer. This involvement triggered the franchisor's disclosure obligations under the Act.

Decision/Holding

The court ruled in favor of the franchisee, holding that the franchisor must comply with statutory disclosure requirements. Since the franchisor failed to meet these obligations, the court found that the franchisee had the right to rescind the agreement and was entitled to damages.

³³⁸ Sovereignty Investment Holdings, Inc v 9127-6907 Quebec Inc, 2008 CanLII 57450 (Ont SCJ)

Significance

This case clarifies the scope of disclosure obligations under the Arthur Wishart Act, particularly in franchise transfers. It underscores that franchisors cannot evade disclosure requirements by characterizing their involvement as passive when, in reality, they play a substantial role in the franchise grant. The decision reinforces the importance of transparency and compliance with statutory disclosure duties in franchise transactions.³³⁹

5. Aroma Franchise Company Inc. et al. v. Aroma Espresso Bar Canada Inc.

Court: Canadian Court

Legal Issue

Anti-suit relief and reasonable apprehension of bias in arbitration proceedings

Facts of the Case

A dispute arose between a Canadian master franchisor, Aroma Franchise Company Inc., and a franchisee regarding interpreting an arbitration clause in their franchise agreement. The agreement stipulated that disputes must be resolved through arbitration, with the arbitrator being either a retired judge or a lawyer with franchise law experience who had no prior social, business, or professional ties to either party.

During arbitration, the franchisee engaged the same arbitrator for an unrelated matter without informing the franchisor. This undisclosed relationship was accidentally revealed when the arbitrator mistakenly sent an email that included a lawyer from the firm representing the franchisee. Meanwhile, the arbitrator issued two cost awards against the franchisor.

Legal Analysis

The franchisor objected to the cost awards, arguing that the undisclosed relationship created a reasonable suspicion of bias. The court reviewed the arbitration clause on Conflicts of Interest in International Arbitration and relevant case law. It assessed whether the arbitrator's undisclosed engagement with the franchisee gave rise to a reasonable apprehension of bias.

Decision/Holding

The court found that the undisclosed relationship between the arbitrator and the franchisee's legal counsel compromised the fairness of the proceedings. It ruled that a reasonable apprehension of bias existed and, as a result, annulled the cost awards. The court ordered a new arbitration with a different arbitrator to confirm procedural fairness.

³³⁹ Ontario Inc. (Jayasena Management Corp) v. Savannah Wells Holdings Inc. 2023 ONSC 100, Melissa Cattini, Ashley Bains, Franchise Case Law Highlights and Noteworthy Decisions During 2023. "See", in <https://www.mltaikins.com/corporate-commercial/franchise-case-law-highlights-and-noteworthy-decisions-during-2023/>

Significance

This case emphasizes the critical role of impartiality in franchise arbitration. It stresses the need for complete transparency regarding any potential conflicts of interest in arbitration, which is essential for preserving the integrity of dispute resolution processes. Additionally, it demonstrates the readiness of Canadian courts to intervene in arbitration rulings when there is a reasonable concern of bias, thereby ensuring fair resolutions of franchise disputes.³⁴⁰

The type of claim described above demonstrates arbitration and court proceedings addressing various legal frameworks, including common law, statutory law, and international law. Such legal principles may vary depending on the jurisdiction and the specific rules governing the case, whether the dispute is handled in a court or through arbitration.

6. *Shoppers Drug Mart Franchisees vs. Shoppers Drug Mart*

Court: Ontario Court of Appeal

Summary

This 10-year class-action lawsuit was resolved by way of a mixed-result summary judgment. The plaintiffs, Shoppers Drug Mart franchisees, alleged that Shoppers Drug Mart (“Shoppers”) owed them substantial amounts for overpaid fees and the non-payment of professional allowances. The case involved claims under the breach of contractual and statutory good faith obligations under Section 3 of the Arthur Wishart Act.

Issues

Whether Shoppers Drug Mart was unjustly enriched by the franchisees’ overpaid fees and non-payment of professional allowances.

Whether Shoppers Drug Mart breached its statutory duty of fair dealing under Law.

Whether the franchisees’ conduct barred their breach of contract claim.

The applicability of arbitration in resolving franchise contract disputes.

Court’s Findings

Unjust Enrichment: The Court ruled that the franchisees’ overpayments did not unjustly enrich Shoppers Drug Mart; therefore, the unjust enrichment claim was unsuccessful.

Breach of Duty of Fair Dealing: The Court found that Shoppers may have breached its statutory duty of fair dealing under Section 3 of the Arthur Wishart Act by unilaterally imposing a procurement and inventory policy on the franchisees.

³⁴⁰ Aroma Franchise Company Inc. et al. v. Aroma Espresso Bar Canada Inc. et al., 2023 ONSC 1827., Melissa Cattini, Ashley Bains, Franchise Case Law Highlights and Noteworthy Decisions During 2023. “See,” in <https://www.mltaikins.com/corporate-commercial/franchise-case-law-highlights-and-noteworthy-decisions-during-2023/>

Breach of Contract: Regarding the breach of contract claim, the Court ruled that the franchisees were barred from alleging breach due to their conduct. Specifically, the franchisees had willingly and eagerly participated in the loyalty program instituted by Shoppers, which the Court found had significant consequences given the costs incurred by Shoppers in reliance on the program.

Arbitration: The Court clarified that participation in class actions, including the decision to apply for arbitration or join a lawsuit, is a matter of individual choice for the franchisees. Furthermore, a franchisee cannot be forced into arbitration unless there is an agreement from all parties. It was also noted that any arbitral award may be overturned if the arbitrator exceeds their powers.

Conclusion

The case was resolved with a mixed result. The unjust enrichment claim was dismissed, while the Court found potential issues with the duty of fair dealing regarding Shoppers' procurement and inventory policy. The franchisees' breach of contract claim was barred due to their participation in the loyalty program. Finally, the Court reaffirmed the voluntary nature of arbitration in contract disputes and the limits on arbitrators' powers.³⁴¹

³⁴¹ Spina v. Shoppers Drug Mart Inc., 2023 ONSC 1086. Melissa Cattini, Ashley Bains, Franchise case law highlights and noteworthy decisions during 2023. "See," in <https://www.mltaikins.com/corporate-commercial/franchise-case-law-highlights-and-noteworthy-decisions-during-2023/>

2.2. United States

U.S. franchise law has established comprehensive policies to prevent fraud, misrepresentation, and violations of intellectual property rights.³⁴² These measures include the Federal Trade Commission's Franchise Rule and the International Franchise Association's Code of Ethics, which promote ethical conduct in franchise operations.³⁴³

The disclosure requirements require extensive documentation to potential franchisees before signing the contract. It includes information such as the franchisor's business experience, history of intellectual property litigation, financial statements, bankruptcy details, restrictions on products and services, territorial rights, trademarks, and patent certificates.³⁴⁴

The Uniform Franchise Offering Circular is considered a vital element of franchising. It provides potential franchisees with crucial information, including fee structures and the parties' responsibilities. In addition to contractual obligations, which often restrict termination rights, franchisors must fulfill relevant statutory requirements and comply with broader legal standards.³⁴⁵ Federal and state franchise laws impose pre-sale disclosure obligations and restrictions. The FTC Rule and most states require franchisors to provide prospective franchisees with the Franchise Disclosure Document upon reasonable.³⁴⁶

The principle of good faith is a pervasive and fundamental aspect of U.S. law. That is why the UCC, which governs commercial transactions, explicitly incorporates it. For instance, every contract or duty within it imposes an obligation to perform in good faith. Parties must fulfill their contractual responsibilities and enforce their rights with fidelity. Although not universally required during negotiation phases, in specific contexts, courts may impose the duty of good faith during contract discussions to prevent misrepresentation or deceit.³⁴⁷

FTC Franchise rules

The US FTC Franchise Rule allows potential franchisees access to essential information for making informed decisions about investing in a franchise. Failure to comply with the Rule results in significant penalties and legal consequences for franchisors.

The Franchise Rule is a regulation designed to protect prospective franchisees by requiring franchisors to provide certain disclosures before the sale of a franchise. Specifically, franchisors

³⁴² Details see Richard L. Rosen et al., Canada, in Iain Bowler ed., *Franchise Laws and Regulations Report 2025*. Published free access at ICLG site: <https://iclg.com/practice-areas/franchise-laws-and-regulations>

³⁴³ Emmerson (1990) 1504-1565.

³⁴⁴ Guenter Treite, *Some Comparative Notes on English and American Contract Law*, SMU law review, 2002, Volume 55, 357-365.

³⁴⁵ Deborah Coldwell, Iris Gibson, William White and Laura Warrick, *Franchise law*, SMU Law Review, 2012, Volume 65, 472-499.

³⁴⁶ FTC Franchise Rule, 2007/16 CFR Parts 436 and 437.

³⁴⁷ Uniform Commercial Code, US, 2012. 1-304.

must offer a detailed document known as the Franchise Disclosure Document (FDD) to potential franchisees at least 14 days before signing agreements or paying fees.

The FDD should include critical information about the franchisor, its litigation history, initial and ongoing fees, and territory restrictions.³⁴⁸

The FTC amends its trade regulation rule titled “Disclosure requirements and prohibitions concerning franchising and business opportunity ventures” to streamline the rule, reduce compliance costs, and address changes in new technologies and market conditions related to the offer and sale of franchises. While Rule 436 outlines these amendments to the Franchise Rule concerning the offer and sale of franchises, Rule 437 presents a revised version of the original Franchise Rule that applies specifically to the offer and sale of business opportunities.³⁴⁹

As emphasized in the introduction of the Rule, based on the original rulemaking record, the FTC found extensive deception in the sale of franchises due to both material misrepresentations and nondisclosures of material facts. Specifically, the FTC discovered that franchisors and business opportunity sellers frequently misrepresent the nature of the seller, the costs associated with purchasing a franchise and other contractual terms, the success rates of the seller and its purchasers, and the seller’s financial viability.³⁵⁰

Regarding unfair or deceptive practices, false or unsubstantiated earnings claims were used to lure prospective purchasers into buying a franchise or business opportunity, and franchisors and business opportunity sellers failed to honor promised refund requests.

Due to these adverse outcomes, the FTC has determined that these practices caused significant economic harm to consumers. Therefore, the final amended Franchise Rules maintain the advantages of the original rules by disclosing essential information needed to make an informed purchasing decision before a sale and prohibiting certain misrepresentations to prevent fraudulent and unfair practices.³⁵¹

Simultaneously, Section 436 of the final amended Rules reduces unnecessary compliance costs and mitigates potential hardships for contracting parties. The rules also clarify that they apply only to franchise sales in the United States. Additionally, the FTC has introduced several new exemptions for franchise purchasers.

This rule benefits from mandating pre-contractual disclosure of five key facts: the franchisor’s financial strength, the business for sale, the required investment, the associated costs, the terms of the agreement, and the business’s success history. To avoid additional deception, the rule

³⁴⁸ FTC Franchise Rule, 2007, USA. 16 CFR Parts 436 and 437.

³⁴⁹ Iris Figueroa Rosario, Jonathan Labukas and Alaina Karsten, *Basics Track: Franchise Litigation*, IFA, Conference Paper, 2018, 1-57.

³⁵⁰ FTC Franchise Rule, 16 CFR Parts 436 and 437. Disclosure Requirements and Prohibitions Concerning Franchising.

³⁵¹ *Ibid*, Statement of Basis and Purpose, 15445.

mandates that franchisors and sellers of business opportunities provide background information while also requiring franchisees to follow the outlined non-compete obligation.

- The name and address of the franchisor or business opportunity seller, any parent company, and the name under which the franchise or business opportunity seller conducts or intends to conduct business, along with its trademarks;
- The prior business experience of the franchisor or business opportunity seller, whether under the same or different trademarks, as well as the seller's affiliations;
- A guarantee that the intellectual property and business model provided under the contract will not be reused or copied for competition in the market after the contract has concluded.³⁵²

The Franchise Rule establishes regulations that protect franchisees' rights and franchisors' business interests from risk. Another specific issue the rule covers is the Commission's adoption of a detailed disclosure requirement for individual trademark franchisee associations.³⁵³

Franchisors must disclose only if the franchisee association requests it in the disclosure document. Before the revision of this rule, all financial performance claims had to be relevant to the geography of the franchise being sold, and income data had to be presented according to generally accepted accounting principles. From this perspective, I conclude that the FTC's amendment to the rule represents a policy effort to simplify franchise disclosure requirements as much as possible.

The rule defines an "affiliated person" as someone with a specific relationship with a franchisor. The three criteria for being an affiliated person include direct or indirect control, which means the person has the power to control the franchisor or is controlled by someone who controls the franchisor. The other two criteria specify that the person owns 10 percent or more of the outstanding voting securities of the franchisor and has a familiar partner, officer, director, trustee, branch manager, or another individual in a similar role or function to the franchisor. In other words, an affiliated person possesses a significant degree of control, ownership, or commonality with a franchisor.³⁵⁴

The FTC's new franchise rule eliminates the four exclusions for non-franchise relationships, which include employer-employee relationships, general partnerships, cooperative associations, certification and testing services, and single trademark licenses. These exclusions are nearly identical to the restrictions outlined in Section 3 of the Arthur Wishart Act.

³⁵² FTC Franchise Rule, 16 CFR Parts 436 and 437, Statement of Basis and Purpose.

³⁵³ FTC Franchise Rule, 16 CFR Parts 436

³⁵⁴ Carl Zwisler, John McNutt and Frank Sciremammano, *A Proposed Mandatory Summary Franchise Disclosure Document*, *Franchise Law Journal*, 2017, Volume 36, 465-490.

Thus, franchise laws in the United States and Canada regard licenses, employer-employee relationships, and standard distributor agreements as non-franchised relationships.³⁵⁵

CASE LAW

When conflicts arise before the signing of a franchise agreement, parties may pursue legal action by filing claims in court, citing issues such as breaches of disclosure obligations, misrepresentation, fraud, or other legal violations. However, whether the resolution is possible at this stage depends on the nature of the dispute and the willingness of both parties to engage in pre-contractual negotiations. In these pre-contractual disputes, main legal principles, such as the duty of good faith and the doctrine of negligent misrepresentation, play a significant role.

I contend that courts in the United States developed a different approach to handling disputes involving pre-franchise agreements than other jurisdictions. The following case studies reveal advanced legal frameworks and procedures that resolve the nuances of pre-contractual disputes in the franchising context.

1. Hoffman v. Red Owl Stores

Court: Wisconsin Supreme Court

Summary

This case involves a dispute between Hoffman and Red Owl Stores concerning preliminary negotiations for a potential franchise agreement. During the talks, the parties discussed entering into a franchise contract contingent upon a met condition.

Relying on Red Owl Stores' promise to invest \$18,000, Hoffman purchased a property to establish a future store. However, Red Owl Stores later breached its promise and demanded additional investment, which Hoffman could not afford. This ultimately resulted in the franchise contract never being finalized.

Legal Issues

Whether Red Owl Stores was liable for the expenses incurred by Hoffman during the preliminary negotiation phase.

Whether Hoffman was entitled to damages despite the absence of a finalized contract.

Whether reliance damages, rather than expectation damages, should be awarded in the case of a breached promise during negotiations.

³⁵⁵ Eric Karp and Ari Stern, *A Proposal for a Mandatory Summary Franchise Disclosure Document*, *Franchise Law Journal*, 2016, Volume 35, 541-576.

Court's Findings

Liability During Preliminary Negotiations: The Court observed that, under traditional legal principles, there is typically no liability for expenses incurred during preliminary negotiations, as the contract was not finalized. Therefore, Red Owl Stores would generally not be held responsible for Hoffman's incurred costs.

Reliance Damages: Despite the general rule, the Court ruled that Hoffman was entitled to reliance damages, which are intended to reimburse a party for the costs incurred due to reliance on an agreement or promise, even in the absence of a finalized contract. The Court did not grant expectation damages, which are typically awarded when a contract exists and one party fails to perform as expected.

Franchisor's Disclosure Obligations: The Court emphasized the importance of franchisors providing accurate income potential claims when selling a franchise opportunity. In this case, Red Owl Stores violated the law by failing to disclose essential information regarding the potential franchise opportunity. As a result, the Court declared the franchise contract invalid and ordered compensation for Hoffman's losses.³⁵⁶

Conclusion

The Court's decision deviated from the traditional principle of no liability during preliminary negotiations by awarding reliance damages to Hoffman. This ruling reflected principles of fairness and justice, ensuring that Hoffman was compensated for the losses incurred due to his reliance on Red Owl Stores' promise. The Court also highlighted the legal obligation of franchisors to disclose factual income potential claims and declared the franchise contract invalid due to non-disclosure.

2. Federal Trade Commission v. Burgerim

Summary

Burgerim, a California-based fast-food franchisor, sold over 1,500 franchises, often targeting inexperienced buyers and making misleading claims about the financial viability of the opportunity. The company marketed its franchise model as a "business in a box," minimized the risks involved, and falsely guaranteed refunds to buyers who could not secure financing. Despite paying franchise fees of up to \$70,000, many franchisees could not open restaurants, and their refund requests went unanswered.

The FTC alleged that Burgerim violated the Franchise Rule and Section 5(a) of the Federal Trade Commission Act, claiming that the company's Franchise Disclosure Document lacked essential information. These omissions included accurate revenue figures, details about its executives, and

³⁵⁶ Donald Harris, Denis Tallon, *Contract Law Today: Anglo-French Comparison*, Oxford: Clarendon Press, 1989, 27. "Hoffman v. Red Owl Stores Inc.-26 USA. Wis. 2 d 683, 133 N.W.2d 267.1965."

the contact information of former franchisees. The FTC further alleged that Burgerim misrepresented its financial performance and failed to honor its refund commitments.

Issues

Whether Burgerim violated the Franchise Rule by failing to disclose accurate financial information and other required details in its Franchise Disclosure Document.

Whether Burgerim's misrepresentations and failure to honor refund guarantees violated Section 5(a) of the FTC Act, the appropriate remedies, including penalties and damages, should address Burgerim's deceptive practices.

Court's Findings

Violation of Franchise Disclosure Requirements: The Court found that Burgerim's Franchise Disclosure Document (FDD) lacked critical information, including accurate revenue figures, executive information, and contact details for former franchisees. The omission of these details violated the Franchise Rule and resulted in deceptive practices.

Misrepresentation of Financial Performance: The Court also found that Burgerim had misrepresented its financial performance, contributing to the misleading marketing of its franchise opportunity. The company falsely guaranteed refunds to franchisees who could not secure financing but failed to honor those commitments.

Violation of Section 5(a) of the FTC Act: The Court ruled that Burgerim's deceptive practices violated Section 5(a) of the FTC Act, which prohibits unfair or deceptive acts or practices in commerce. The company's misleading statements about the franchise opportunity and failure to fulfill refund promises were found to violate federal law.

Remedies

The FTC sought an injunction, monetary damages, and penalties of up to \$46,517 per violation. The case underscores the federal authorities' commitment to enforcing transparency and fairness within the franchising industry.

Conclusion

This case is significant because it illustrates federal authorities' resolve to hold franchisors accountable for deceptive practices and violations of franchise disclosure rules. The Court's decision highlights the importance of proper disclosure and honest representation in franchise offerings and signals the federal government's increasing oversight of the franchise sector.³⁵⁷

³⁵⁷ Burger IM, U.S. v., FTC Matter/File Number 2023057, Civil Action Number 2:22-cv-00825.

3. Federal Trade Commission v. American Driveline Systems, Inc.

Summary

The case centered on the Federal Trade Commission's enforcement action against American Driveline Systems, Inc., a franchisor in the automotive repair sector, for violating the Franchise Rule and engaging in unfair and deceptive business practices. The FTC alleged that American Driveline failed to provide prospective franchisees with the required Franchise Disclosure Document, which is mandated by the Franchise Rule and includes crucial information, such as financial performance representations and the terms of the franchise agreement.

These omissions and misrepresentations about the franchise opportunity misled potential franchisees regarding the nature of the investment and the risks involved. Additionally, the FTC claimed that American Driveline's marketing practices included false claims about the profitability and success of its franchise system, which directly violated both disclosure requirements and legal protections for prospective franchisees under U.S. law.

Issues

The case examined whether American Driveline violated the FTC's Franchise Rule by failing to provide prospective franchisees with a complete Franchise Disclosure Document. It also considered whether the company's false claims about the profitability of its franchise system constituted deceptive business practices under U.S. law. The appropriate remedies for American Driveline's failure to comply with the Franchise Rule included a permanent injunction and restitution.

Court's Findings

Failure to Provide Franchise Disclosure Document: The Court found that American Driveline violated the Franchise Rule by not providing prospective franchisees with the necessary FDD. The omission of critical information, such as financial performance representations and terms of the franchise agreement, led to misleading and deceptive practices.

Deceptive Marketing Practices: The Court determined that American Driveline engaged in false and misleading marketing by making claims about the franchise's profitability and success, which misled prospective franchisees about the nature and risks of the investment. These practices violated the Franchise Rule and consumer protection laws under the FTC Act.

Violation of the Franchise Rule: The Court concluded that American Driveline's failure to comply with the Franchise Rule and its deceptive marketing practices warranted enforcement action under federal law.

Remedies

In 2014, the FTC filed a civil complaint seeking a permanent injunction against American Driveline to prevent further deceptive practices and restitution for the harm caused to consumers.

The FTC highlighted that the company had continued its deceptive conduct despite prior warnings, emphasizing the need for more vigorous enforcement of the Franchise Rule.

Conclusion

This case illustrates the FTC's commitment to rigorously enforcing the Franchise Rule. The Court's decision reinforced the importance of compliance with disclosure requirements and highlighted the consequences of deceptive business practices in the franchising industry.³⁵⁸

4. *Century 21 Real Estate LLC v. All Professional Realty, Inc.*

Court: District Court Eastern District of California

Summary

The case involved trademark infringement and breach of contract in a franchise relationship. Century 21, a well-known real estate franchise, terminated its franchise agreement with All Professional Realty, Inc. after the franchisee violated the terms of the contract. Following the termination, All Professional Realty continued using the Century 21 trademark in its marketing materials despite no longer being authorized under the franchise agreement.

The central issue of the dispute was the unauthorized use of the Century 21 trademark after the franchise agreement's termination. Century 21, as the franchisor, sought to protect its trademarks from unauthorized use, particularly after the franchise relationship had ended.

Issues

Whether All Professional Realty violated the franchise agreement by continuing to use the Century 21 trademark after the termination of the contract. Century 21, the franchisor, was entitled to financial damages and injunctive relief for the franchisee's unauthorized use of its trademark and the importance of protecting trademark rights in franchise relationships.

Court's Findings

Trademark Infringement: The Court ruled that All Professional Realty's continued use of the Century 21 trademark after terminating the franchise agreement constituted unauthorized trademark use, a breach of the contract's terms. **Breach of Contract:** The Court found that the franchisee's actions violated the provisions of the franchise agreement, particularly those related to using the franchisor's trademark after the agreement had been terminated. **Franchisor's Right to Protect Its Brand:** The Court reinforced the franchisor's right to safeguard its trademarks and brand identity from unauthorized use, emphasizing the importance of adhering to contract provisions regarding trademark use.

Remedies

³⁵⁸ American Future Systems, Inc. FTC Matter/File Number 172 3085, Civil Action Number 2:20-cv-02266.

The Court ruled in favor of Century 21, ordering All Professional Realty to cease the unauthorized use of its trademarks. Additionally, the Court imposed financial damages on the franchisee for breaching the franchise agreement, underscoring the importance of compliance with the agreement's terms, especially regarding trademark usage.

Conclusion

The unauthorized use of a franchisor's trademark, particularly after the termination of the franchise relationship, can lead to significant legal action.

Franchise agreements typically include strict provisions regarding the permissible use of trademarks, and failure to adhere to these provisions can result in financial and legal consequences.³⁵⁹

5. *Kendall v. Franchise Associates, Inc.*

Court: United States Court of Appeals for the Ninth Circuit

Summary

The case involved a dispute between a franchisee, Kendall, and a franchisor, Franchise Associates, Inc., concerning territorial exclusivity under their franchise agreement. The plaintiff claimed that the franchisor violated the deal by allowing another franchisee to operate within the same territory, resulting in a monopolistic market that harmed the plaintiff's business. Kendall argued that such actions breached the franchisor's contractual obligation to grant exclusive territorial rights.

Issues

Whether Franchise Associates violated the franchise agreement by granting overlapping territorial rights to multiple franchisees, thereby creating unfair competition or monopolistic practices.

Whether the franchisor's actions breached the exclusivity provisions of the franchise agreement.

The legality of exclusive territorial rights in franchise agreements under U.S. antitrust laws.

Court's Findings

Violation of Territorial Exclusivity: The Court ruled in favor of the plaintiff, Kendall, concluding that Franchise Associates had violated the franchise agreement by failing to uphold the exclusive territory granted to the plaintiff. Breach of Contract: The Court found that the franchisor's actions were inconsistent with the terms of the agreement, which included provisions for territorial exclusivity, and that these actions unfairly impacted the plaintiff's business interests.

³⁵⁹ United States District Court Eastern District of California, No. Civ. 2:10-2751 Wbs Ggh (E.D. Cal. Aug. 7, 2012)

Prevention of Monopolistic Practices: The Court highlighted franchisors' need to comply with territorial exclusivity clauses in franchise agreements to prevent unfair competition and monopolistic practices. The ruling reinforced the need for franchises to avoid dividing markets or engaging in monopolistic behavior that violates antitrust laws.

Legal Implications

Exclusive Territories: The Court affirmed that franchisors can grant exclusive territories to franchisees. However, these agreements must be carefully structured to prevent the creation of unreasonable trade restraints, illegal market division, or monopolization.

Resale Price Maintenance: The Court addressed the prohibition of resale price maintenance under U.S. antitrust laws, noting that while franchisors can recommend pricing, they must avoid practices that could be deemed overly restrictive or anti-competitive.

Non-Compete Agreements: The Court emphasized that non-compete clauses in franchise agreements must be reasonable in scope, duration, and geographic area to be enforceable under the law.³⁶⁰

Conclusion

This case underscores the importance of territorial rights in franchise agreements and the critical role franchisees play in protecting their business interests. The Court's decision reinforced the need for franchisors to structure territorial exclusivity provisions to avoid unfair competition and monopolistic practices while ensuring compliance with antitrust laws. Additionally, the case emphasizes that non-compete clauses and pricing recommendations must comply with legal standards to avoid undue restrictions on trade.³⁶¹

6. *Franchisees v. Meineke Discount Muffler, Inc.*

In the US court, mass franchise actions are joint actions by more than one petitioner who participates in a class of franchisees against the respondent.³⁶² Technically, such an agreement takes either the form of an arbitration clause or a submission agreement.³⁶³

Summary

This case involved a lawsuit filed by a group of franchisees against Meineke Discount Muffler, Inc. and its affiliated entities, alleging violations related to the management of advertising funds. The plaintiffs contended that the franchisor's actions were in breach of the Franchise and Trademark Agreements, and in addition to contractual claims, they raised tort claims related to unfair trade practices.

³⁶⁰ United States Court of Appeals for the Ninth Circuit, 40 U.S. 518 (1980)

³⁶¹ William Page, *Direct Evidence of a Sherman Act Agreement*, Antitrust Law Journal, 2020, Volume 83, 347-392.

³⁶² Barry Heller, Robert Zarco, *The 7 Most Significant Franchise Cases of All Time*, ABA, 2014, 16.

³⁶³ Michael Garner, Stephen Hagedorn and Leonard MacPhee, *Mass litigation by Franchisees*, IFA, 2012, 8.

The lawsuit stemmed from the franchisor's alleged mishandling of advertising funds, which the plaintiffs argued violated statutory provisions and constituted unfair trade practices under relevant laws.

Issues

Whether the franchisor violated the terms of the Franchise and Trademark Agreements by mismanaging advertising funds, and whether such actions constituted statutory unfair trade practices. Additionally, the case raises the issue of whether it could proceed as a class action, considering the conflicting interests among the franchisees.

Court's Findings

Violation of Franchise and Trademark Agreements: The Court found that the franchisor's management of advertising funds violated the terms of the Franchise and Trademark Agreements.

Unfair Trade Practices: The Court held that the franchisor's actions constituted unfair trade practices under applicable statutory law.

Class Action Challenges: While the franchisees secured a substantial judgment of \$390 million, the case highlighted significant challenges in pursuing class-action litigation in the franchising context. The Court noted that the diverse and conflicting interests among the franchisees complicated the ability to pursue collective legal action. The primary conflicts concerned differing views on the appropriate type and scope of relief for the alleged misconduct.

Legal Implications

Advertising Fund Management: This case underscores the importance of franchisors' proper management of advertising funds by franchise agreements. Mismanagement can lead to both contractual breaches and tort claims, including violations of unfair trade practices laws.

Class Action Complications in Franchising: The case illustrates the complexities of class-action lawsuits in the franchising sector. Franchisees' divergent interests can create significant obstacles to collective legal action, complicating a unified legal strategy.

Statutory Unfair Trade Practices: The decision highlights the enforcement of statutory provisions related to unfair trade practices and the potential for tort claims in franchising disputes, particularly regarding mismanagement and financial transparency.

Conclusion

This case is a significant example of franchisor liability in managing advertising funds and the complexity of class-action lawsuits in franchising. It highlights the importance of compliance with franchise agreements and the legal challenges that arise when franchisees' interests diverge in collective legal actions. Despite the considerable judgment awarded, the case reveals that

franchising disputes can be complicated to manage in a class-action format due to the varied interests of individual franchisees.³⁶⁴

7. Bazzle v. Green Tree Financial Corp. (Plaintiff) v. Green Tree Financial Corp.

Court: South Carolina Supreme Court, US

Summary

This case involved a contract dispute between Lynn and Burt Bazzle (Plaintiffs) and Green Tree Financial Corporation (Defendant).

After initiating the lawsuit, the Plaintiffs learned that other Green Tree customers were experiencing similar issues related to the dispute. Consequently, they sought permission to file a class action lawsuit. However, Green Tree's contracts included a clause requiring arbitration to resolve conflicts, leading the company to request the court to revoke the class certification. Green Tree argued that the Federal Arbitration Act did not allow class-wide arbitration and that arbitration should proceed on a case-by-case basis.

Legal Issues

Should the class certification be revoked due to the arbitration clause in Green Tree's contracts, which required individual arbitration of disputes?

Whether the Federal Arbitration Act permits class-wide arbitration without an explicit contract prohibition.

Court's Findings

Class Certification and Arbitration: The South Carolina Supreme Court ruled in favor of the Plaintiffs, holding that courts could permit class-wide arbitration unless explicitly prohibited in the arbitration agreement.

Federal Arbitration Act: The court disagreed with Green Tree's argument, stating that the Federal Arbitration Act did not preclude class-wide arbitration if the contract did not expressly ban it.

Legal Implications

Class-wide Arbitration: The decision reinforced that class-wide arbitration is permissible, provided no explicit contractual language prohibits it.³⁶⁵

Federal Arbitration Act: The case clarified that the FAA does not categorically prevent class-wide arbitration, and the enforceability of class actions in arbitration depends on the terms of the underlying contract.

³⁶⁴ Broussard v. Meineke Discount Muffler Shops 1998, US, No.87-1808.

"See," in <https://casetext.com/case/broussard-v-meineke-discount-muffler-shops-inc>

³⁶⁵ Susan Ellis Wild, *Law Dictionary*, Merriam-Webster, 2006, 11.

Conclusion

The South Carolina Supreme Court's decision emphasized that class-wide arbitration could proceed without a specific contractual ban, underscoring arbitration's flexibility as a dispute resolution mechanism. This ruling set a significant precedent regarding how courts interpret the scope of the Federal Arbitration Act about class actions.³⁶⁶

8. *Employee Plaintiffs v. Jimmy John's Franchise, LLC*

Court: United States District Court, Illinois

Summary

This case involved a dispute over the enforceability of non-compete agreements imposed by Jimmy John's, a national sandwich chain, on its franchise employees. The agreements restricted employees from working for competing sandwich shops or starting similar businesses. The dispute arose in the context of arbitration proceedings initiated by franchisees, raising broader legal concerns regarding the validity of non-compete clauses in franchise agreements.

Legal Issues

Whether the non-compete agreements imposed on franchise employees were legally enforceable and whether the employee plaintiffs had standing to seek declaratory relief regarding the validity and enforceability of the Confidentiality and Non-Competition Agreements.

Court's Findings

Standing of Employee Plaintiffs: The United States District Court in Illinois ruled that the two employee plaintiffs lacked standing to pursue their claims for declaratory relief. The court held that they failed to establish a legal interest sufficient to challenge the enforceability of the non-compete agreements.

Legal Considerations of Non-Compete Clauses: Although the court did not rule on the substantive validity of Jimmy John's non-compete agreements, the case underscored the complexities of enforcing such clauses, particularly in the franchise employment context.

Legal Implications

Non-Compete Agreements in Franchising: The case highlighted the increasing scrutiny of restrictive covenants in employment agreements, especially in low-wage franchise settings. Courts continue to evaluate whether such agreements constitute an unreasonable restraint on trade.

Standing in Declaratory Actions: The ruling reinforced the principle that plaintiffs must demonstrate a concrete legal interest to seek declaratory relief regarding contractual provisions. Without a direct and immediate legal stake, courts may dismiss such claims on standing grounds.

³⁶⁶ "Green Tree Financial Corp. v. Bazzle, 539 US 444. 2003, "See," in www.oyez.org/cases/2002/02-634

Conclusion

The case illustrates the legal challenges surrounding non-compete agreements in the franchising industry. While the court dismissed the employee plaintiffs' claims for lack of standing, whether such agreements are enforceable remains a contentious topic in franchise employment law.³⁶⁷

2.3. England

Franchise is not defined under English statutes and there is no clear definition under case law. Nevertheless, the British Franchise Association's (BFA) Code of Ethics for Franchising adopts the definition of franchising taken from the European Code of Ethics for Franchising.³⁶⁸

Franchise agreements in England are treated as private contracts under common law. Key principles such as offer and acceptance, consideration, and misrepresentation play a crucial role in determining the rights and obligations of franchisors and franchisees.

English contract law emphasizes the parties' freedom to negotiate and enter into agreements based on their terms while following legal limitations and requirements. In English contract law, the significance of a term in a contract can be important when determining if a breach of that term warrants the termination of the contract.

Courts often evaluate whether the term is a "condition" or a "warranty." If a condition is breached, the non-breaching party is typically entitled to terminate the contract and seek damages.³⁶⁹

It may allow parties to terminate discussions without the risk of facing legal consequences for non-performance or failure to commit. However, the absence of binding pre-contractual regulations can create situations where one party incurs significant reliance losses after making considerable investments or entering into commitments based on the reasonable expectation of a finalized agreement.³⁷⁰

The UK Code of Ethics for franchising offers a thorough set of standards and principles to guide the conduct of both franchisors and franchisees. As part of its requirements, franchisors must disclose information in writing to prospective franchisees.

According to the Code of Ethics, the franchise agreement should include the definition "grant of rights" clause, which explicitly outlines the franchisee's rights to use the franchisor's intellectual property.³⁷¹

³⁶⁷ US 14-C-5509. 2015, "See," in <https://casetext.com/case/brunner-v-james-john-liautaud-jimmy-johns-llc>

³⁶⁸ Details see Iain Bowler, England & Wales, in Iain Bowler ed., *Franchise Laws and Regulations Report 2025*.
Published free access at ICLG site: <https://iclg.com/practice-areas/franchise-laws-and-regulations>

³⁶⁹ Andrew Burrows, *English Private Law*, Oxford University Press, 2007, 6.

³⁷⁰ Pratt (2012) 95-103.

³⁷¹ *The BFA Extension and Interpretation of the Code*, British Franchise Association, 2020, Article 1-8.

The absence of a dedicated franchise law in the United Kingdom also means that franchise agreements are governed by a combination of contract law, competition law, consumer protection law, and intellectual property law, creating a complex yet flexible regulatory framework.³⁷²

The UK's competition law framework, particularly the Competition Act 1998 and the Enterprise Act 2002 restricts unfair terms in franchising agreements.³⁷³

CASE LAW

1. Pronuptia de Paris GmbH v. Schillgallis

Court: The Court of Justice of the European Union

Background

The German Federal Court of Justice referred the case to the Court of Justice under Article 177 of the EEC Treaty (now Article 267 TFEU), seeking a preliminary ruling on the interpretation of Article 85 of the EEC Treaty (now Article 101 TFEU), which prohibits anti-competitive agreements. Additionally, the case examined Commission Regulation No. 67/67/EEC, which applied Article 85(3) to specific exclusive dealing agreements.

The dispute involved whether Schillgallis, a franchisee, was obligated to pay fees in arrears to the franchisor, Pronuptia de Paris GmbH and whether the franchise agreement terms complied with European competition law.

Legal Issues

Whether the franchise agreement's terms were compatible with Article 85(1) EEC (now Article 101(1) TFEU) concerning restrictive trade practices.

Certain contractual restrictions imposed by the franchisor could be justified under Article 85(3) EEC (now Article 101(3) TFEU) as necessary for protecting the franchise system.

Whether clauses regarding pricing and operational control unduly restricted the competitive independence of the franchisee.

Court's Findings

Legitimacy of Franchise Restrictions: The Court recognized that franchisors must protect critical business interests, such as safeguarding know-how, ensuring brand consistency, and maintaining network uniformity. Reasonable territorial exclusivity and operational requirements could be justified if proportionate to achieving these legitimate objectives.

³⁷² Rowley (2004) 119-124.

³⁷³ Harold Brown, *Case Against Contractual Arbitration Covenants*, Franchise Law Journal, 1992, Volume 11, 112-114.

Prohibited Anti-Competitive Clauses: Price-fixing clauses: The Court ruled that any provision imposing rigid price controls on franchisees was incompatible with Article 85(1) EEC, as it restricted independent pricing decisions.

Excessive operational restrictions: Any constraints on franchisee autonomy that went beyond what was necessary for brand protection could be deemed anti-competitive.

Balance Between Franchise Protection & Competition Law Compliance: The judgment clarified the boundary between legitimate franchisor control and unlawful competition restrictions. Franchise agreements must preserve franchisee independence while permitting necessary controls to protect franchisor interests.

Legal Implications

Franchise agreements must comply with EU competition law by ensuring that restrictions imposed on franchisees are proportionate and necessary to achieve legitimate business objectives. Franchisors cannot impose rigid price controls or excessive operational constraints that limit a franchisee's competitive autonomy. Future franchise agreements must be structured carefully to balance network protection and market competition by Article 101 TFEU.

Conclusion

The Pronuptia ruling provided landmark guidance on how franchise agreements should be drafted under European competition law. It reinforced the principle that while franchisors have a right to protect their business model, franchisees must retain enough autonomy to remain competitively independent. This case remains a key reference in franchise law within the EU.³⁷⁴

2. *Auto Garage Solutions v. Sawyers*

Background

Auto Garage Solutions (AGS), a franchisor, entered into a franchise agreement with Mr. Sawyers, allowing him to operate a garage under the AGS brand. The agreement included detailed terms regarding operations, marketing, and financial contributions required from the franchisee. Mr. Sawyers alleged that AGS made several misrepresentations during pre-contractual negotiations, particularly regarding the franchise's profitability and the training and support AGS would provide. He further claimed that AGS breached the franchise agreement by failing to deliver the promised training and support, significantly impacting his ability to operate the franchise successfully.

Legal Issues

Misrepresentation: Whether AGS's statements about profitability and franchisor support during pre-contractual negotiations amounted to misrepresentation under contract law.

³⁷⁴ Case C-161/84, The Court of Justice of the European Union, "See also in," Dnes (1993), 367-393.

Breach of Contract: Whether AGS failed to provide the promised training and support, thereby breaching the terms of the franchise agreement.

Rescission & Damages: Was Mr. Sawyer entitled to rescind the contract and receive damages for losses due to AGS's misrepresentations and breaches?

Court's Findings

The court found that AGS made misleading statements regarding profitability and franchisee support, which influenced Mr. Sawyer's decision to enter into the franchise agreement. As a result, the court ruled that these misrepresentations provided sufficient grounds for rescinding the contract.

Breach of Contract

AGS failed to provide adequate training and support, which was explicitly required under the franchise agreement.

The failure to uphold these obligations materially affected Mr. Sawyer's ability to operate the business.

The court held that this constituted a breach of contract, justifying Mr. Sawyer's termination of the agreement.

Rescission & Damages

Given the misrepresentation and breach, the court ruled that Mr. Sawyer was entitled to rescind the franchise agreement.

The court awarded damages to compensate for the losses incurred due to AGS's misrepresentations and contractual breaches.

Legal Implications

Franchisors must confirm that pre-contractual statements about profitability and support are accurate to avoid liability for misrepresentation.

Failure to provide contractual obligations, such as training and operational support, can lead to rescission and damages.

This case underscores the importance of transparency in franchise agreements and the legal consequences of failing to fulfill promised support.

Conclusion

The court's ruling in *Auto Garage Solutions v. Sawyer* reinforces franchisors' duty to provide truthful information and fulfill contractual commitments. Misleading statements and breaches of

contract can lead to rescission, termination, and financial liability for franchisors, highlighting the necessity for fair dealing and transparency in franchise relationships.³⁷⁵

3. Papa John (Plaintiff) v. Doyle (Defendant)

Summary

The plaintiff, Papa John, invested in the defendant Doyle's company based on optimistic financial projections before signing the franchise agreement. However, the business failed due to Doyle's lack of experience in the industry. As a result, Papa John suffered significant financial losses and initiated legal action against Doyle. Doyle counterclaimed, arguing that the franchisor failed to disclose critical business methods adequately before the agreement was finalized.

Issues

Whether the franchisor's pre-contractual financial estimates constituted a binding commitment.

Whether the defendant's claim of inadequate disclosure by the franchisor had legal merit.

Whether the franchisor or franchisee bore responsibility for the failure of the business.

Court's Findings

Pre-Contractual Estimates: The court ruled that the franchisor's pre-contractual financial projections were not legally binding, as they were not included in the final written franchise agreement.

Breach of Disclosure Obligations: The court dismissed the defendant's counterclaim, holding that the franchisor was not obligated to disclose additional business methods beyond those specified in the signed contract.

Finality of the Agreement: The judgment reaffirmed the principle that once a franchise agreement is signed, the parties are bound by its terms, and prior negotiations or projections have no legal standing unless explicitly incorporated into the contract.

Legal Implications

Due Diligence in Franchise Selection: The case underscores the importance of franchisors conducting thorough vetting of potential franchisees to certify they possess the necessary experience and qualifications.

Pre-Contractual Representations: The contract must explicitly state financial projections or profitability estimates to be legally enforceable. Otherwise, they are generally considered non-binding unless they constitute fraudulent misrepresentation.

³⁷⁵ John Pratt, *Franchising in the United Kingdom*, Franchise Law Journal, 2012, Volume 32, 95-104.

Disclosure Obligations: While franchisors must provide transparent and accurate information, franchisees are also expected to conduct independent due diligence before entering an agreement.³⁷⁶

4. Care Watch Ltd. v. Focus Ltd.

Facts

Care Watch Ltd., a provider of residential care services in East Anglia, entered into a franchise agreement with Focus Ltd. to operate in designated areas. The agreement was later terminated due to a breach of obligations. Following the termination, Focus continued operating a business, violating the non-compete clause stipulated in the franchise agreement.

Claims

Care Watch filed a claim seeking an injunction to prevent Focus from violating the restrictive covenant and damages for losses incurred due to Focus's post-termination competitive activities.

Decision/Holding

The court ruled in favor of Care Watch, upholding the enforceability of the competition restriction clause. After the franchise agreement's termination, the court granted an injunction preventing 'Focus' from engaging in competing activities within the designated geographical area. Additionally, the court addressed the losses suffered by Care Watch due to the breach.

Significance

The case underscores the binding nature of franchise agreements, particularly in enforcing restrictive covenants post-termination. The ruling affirms that franchisees must comply with contractual obligations, reinforcing the importance of clearly defined non-compete clauses in franchise agreements.³⁷⁷

5. Robertson v. Kangol

Facts

Under the terms of the trademark license agreement, the licensee was required to pay Kangol, the appellant, a running royalty of 7.5 percent of the wholesale price for products bearing the Kangol trademark. The agreement further stipulated that failure to meet the minimum royalty payment would grant Kangol the right to terminate the agreement immediately.

Issue

Whether Kangol was entitled to terminate the trademark license agreement with immediate effect due to the licensee's failure to fulfill the royalty payment obligations.

³⁷⁶ Papa Johns (Gb) Ltd v Elsada Doyley, England & Wales, Queen's Bench Division, [2011] EWHC 2621 (QB).

³⁷⁷ Care watch Care Services Ltd v. Focus Caring Services Ltd, England and Wales, [2014] EWHC 2313

Decision/Holding

The Court of Appeal upheld the enforceability of the contractual provision, ruling that a trademark license agreement could be terminated immediately if the licensee failed to meet the agreed financial obligations.

Reasoning

The court emphasized the importance of adhering to the financial obligations outlined in trademark licensing agreements. It reinforced the principle that failure to comply with payment terms, mainly concerning royalty payments, constituted a material breach justifying immediate termination. The ruling affirmed trademark licensors' right to protect their financial interests through prompt termination in cases of non-payment.³⁷⁸

2.4. Australia

The unfair contract terms defined by Australian consumer law resemble the US Franchise Rule due to their shared goal of protecting franchisees from abusive practices and establishing fairness within the franchise relationship. The regulation addresses the inherent power imbalance between franchisors and franchisees, aiming to prevent exploitation. The rules concerning unfair contract terms apply to standard-form contracts, which often include franchise agreements. The Australian Consumer Law governs it, part of the Competition and Consumer Act 2010.³⁷⁹

Under section 24 of the ACL, a term in a standard form contract is deemed unfair if it creates a significant imbalance in the parties' rights and obligations. The concept of the law underscores that franchisees typically have little or no capacity to negotiate the terms. Conversely, it is not reasonably necessary to protect the legitimate interests of the advantaged party (usually the franchisor).

Unfair agreements allow the franchisor to change fees, territories, or operational requirements unilaterally, impose disproportionate penalties for minor breaches by the franchisee, and include clauses restricting the franchisee's ability to terminate the agreement, even when the franchisor fails to meet its obligations. Furthermore, it is emphasized that non-compete clauses impose unreasonable restrictions on the franchisee after termination. Therefore, the regulation of unfair contract terms under the ACL reflects Australia's commitment to protecting small businesses and franchisees by addressing the inherent power imbalance in franchise relationships. As a result of the law, if a court or tribunal finds a term unfair, it is declared void, meaning it cannot be enforced.³⁸⁰

Under sections 23-25 of the ACL, a contract term is deemed unfair if it creates a significant imbalance in the parties' rights and obligations or is not reasonably necessary to protect the

³⁷⁸ Kangol Ltd v Hay and Robertson Plc: [2004] EWCA Civ 63.

³⁷⁹ The Australian Consumer Law, Schedule 2 of the Competition and Consumer Act 2010. Part 2-3: Unfair Contract Terms.

³⁸⁰ *Ibid*, Part 3-1: Unfair Practices, Division 1. Section 29.

legitimate interests of the advantaged party. As previously noted, these provisions apply specifically to standard-form contracts, which are often non-negotiable and heavily favor the drafting party.

Section 25 provides examples of unfair terms, which can lead to an imbalance in the rights and obligations of the parties to the contract. An unfair term prevents one party from fulfilling obligations while binding the other. For instance, a franchisor may refrain from providing certain promised support services in the agreement while the franchisee remains obligated to pay royalties.

A term that allows one party to quickly terminate the contract while imposing strict conditions on the other is unjust. For example, a franchisor can terminate a franchise agreement at will, but the franchisee must provide extensive notice and pay penalties.

Penalizing only one party (e.g., through high exit fees or liquidated damages) is unfair. For instance, a franchisee incurs a steep penalty for early termination, while the franchisor faces no penalties for breach, among other situations.

A clause that allows one party to modify the agreement without input from the other is often unfair. For example, a franchisor probably unilaterally increases royalty rates or changes operational requirements without negotiation. Terms that give one party the sole discretion to renew or not renew the contract can be problematic. A franchisor may arbitrarily decide whether to renew the franchise agreement without providing objective criteria or recourse for the franchisee.

Furthermore, allowing one party to change the price while preventing the other party from terminating the contract is unjust. In this scenario, a supplier can raise product prices under a contract, yet the buyer cannot exit the agreement. A clause that permits one party to change the characteristics of the supplied product or service unilaterally may be considered inequitable.

Consequently, a franchisor may modify product specifications, imposing additional expensive modifications on the franchisee. If a franchisor concludes that a franchisee is not meeting operational standards without an independent review process, or if one party has the authority to determine whether the other party has violated the contract, it erodes fairness. Additionally, a clause allowing one party to transfer the contract to another individual without the other party's consent can result in unjust outcomes. A provision that prevents one party from taking legal action against the other can also be deemed unfair.³⁸¹

According to research by the Australian Competition and Consumer Commission, exclusive supply arrangements are common in franchising. When entering a franchise system, it is standard for franchisors to specify the types of products that franchisees must purchase for their business and/or which suppliers they can use. Details about approved products or suppliers are often

³⁸¹ The Australian Consumer Law, Schedule 2 of the Competition and Consumer Act 2010. Section 25. Examples of Unfair Terms.

included in the operations manual, a critical document for standardizing the franchise system. Franchisors have valid reasons for controlling the products or services their franchisees use. These controls are vital for protecting the integrity of the franchise system, validating compliance with standards, and safeguarding the brand's reputation.³⁸²

As an emphasized commission, restraint of trade clauses, particularly in the franchising sector, often incorporate cascading restraint clauses ("step clauses") to enhance their enforceability. These typically cover a range of geographical areas, periods, or the scope of restricted activities, allowing courts to sever unreasonable parts while retaining those deemed reasonable.

These legal regulations for franchisors operating in Australia are probably overly restrictive; however, they effectively stabilize franchise relationships and establish fair contracts. Therefore, consumer law can be seen as progressive, as it mitigates the risk of franchisors exploiting their advantages to shape contract terms that favor them and limit fair competition.

According to Case law, franchisees often express concerns about the quality or consistency of the products or services provided by the franchisor. For instance, disputes may happen over how advertising and marketing funds are allocated, the effectiveness of marketing campaigns, or the level of ongoing support offered by the franchisor.

Financial disagreements can involve royalty fees, accounting practices, or the franchisor's financial reporting. Franchisees probably contest the franchisor's enforcement of operational standards or compliance requirements, which could include disputes over training programs, operational procedures, or health and safety standards.

Therefore, regulatory compliance is another main area, encompassing potential violations of franchise disclosure laws, consumer protection regulations, or antitrust laws. Most franchise disputes related to licensing, supervision and support, system implication, material, product prices, payments, or accounting, post-termination arise among the franchisor and franchisee, license owner, manufacturer, and distributor.

Accordingly, precedent is used to resolve franchise-related litigation in the proceedings. For instance, Australian Courts generally look to American cases and relevant Australian codes to guide the definition of a 'system or marketing plan.' The Australian court considers the meaning of "franchise agreement" under the Code. It sets out several indicators that are to be used when determining the existence of a system or marketing plan.

Which includes: a) the provision by the franchisor of a detailed compensation and structure for distributors b) centralized bookkeeping and record-keeping provided by the franchisor for distributors; c) a scheme prescribed by the franchisor under which a person could become a distributor; d) approve promotional materials used by distributors; e) a prohibition on re-packaging of products by distributors; f) the provision of assistance by the alleged franchisor to

³⁸² Australian Competition and Consumer Commission, Unfair Contract Terms in Franchise Agreements, Key Findings of Targeted Compliance Checks on Franchisors, 2023, 6.

its distributors in conducting opportunity meetings; g) suggestion by the franchisor of the retail prices to be charged for products.³⁸³

CASE LAW

1. ACCC v. Kyloe Pty Ltd

Facts

The Australian Federal Court was asked whether two distribution companies had inadvertently formed a franchise agreement. The case involved the Australian Competition and Consumer Commission (ACCC) and Kyloe Pty Ltd.

The Court referenced its prior decision in Capital Networks Pty Ltd to assess the criteria outlined in the Franchising Code of Conduct. This Code defines when an agreement qualifies as a “franchise agreement.” The main issue was whether a franchise agreement existed between the parties and whether it met the criteria under the Franchising Code.

Legal Issue

Whether an agreement between two distribution companies constituted a “franchise agreement” under the Franchising Code of Conduct.

Decision/Holding

The Federal Court ruled that no franchise agreement existed in this case. However, the judgment provided essential insights into defining a “system or marketing plan,” a key element of a franchise agreement under the Code.

Reasoning

The Court clarified the meaning of a “system or marketing plan,” emphasizing its role in distinguishing franchise agreements from other business arrangements. The judgment examined the criteria for identifying a franchise agreement and guided how this term should be understood. In doing so, the Court noted the influence of international legal frameworks, including American jurisprudence, in shaping the interpretation and application of franchising principles in Australia.

Significance and Conclusion

This case contributed significantly to the understanding and application of franchising principles in Australian law. The Court’s detailed analysis of the “system or marketing plan” offers greater clarity for businesses and legal practitioners in identifying whether an arrangement qualifies as a franchise agreement under Australian law.

³⁸³ Chalermwut Sriporom, *Franchising Legal Frameworks: A Comparative Study of the DCFR, US law and Australian law regarding franchise contracts*, Universiteit Leiden, 2023, 49. “FCA 808 (2004) Capital Networks Pty Ltd v. au Domain Administration Ltd.”

The ACCC v. Kyloe Pty Ltd case strengthened the framework for identifying franchise agreements in Australian law, offering more precise guidelines for interpreting the key components of such contracts. The Court's reliance on previous decisions and international legal principles adds to the growing body of case law guiding the development of franchising in Australia.³⁸⁴

2. Australian Competition and Consumer Commission v. Fuji Xerox Australia Pty Ltd

Facts

The Australian Competition and Consumer Commission (ACCC) initiated proceedings against Fuji Xerox Australia for alleged violations of Australian consumer law, mainly focusing on unfair contract terms and misleading or deceptive conduct. Fuji Xerox, a supplier of office tools and related services, had entered into standard form contracts with small businesses.

Issue

Specific terms in Fuji Xerox's standard form contracts, including automatic renewal clauses and onerous termination clauses, were unfair and violated provisions.

Holding

The Federal Court found several terms in Fuji Xerox's contracts with small businesses unfair. Specifically, the court ruled that terms permitting automatic renewals without clear communication to customers and imposing significant fees for early termination were deemed unjust and in violation of Australian consumer law.

Reasoning

The Court determined that Fuji Xerox's automatic renewal clauses locked small businesses into extended contract periods without adequate notification, violating the fairness requirement under Australian Consumer Law.

Additionally, the early termination clauses were found to impose disproportionate penalties on small businesses, further undermining the fairness of the contracts. The court also concluded that Fuji Xerox misled customers regarding their ability to terminate contracts or switch service providers, violating the Australian Consumer Law's provisions on misleading conduct.

Significance

This case is a landmark decision in consumer law, particularly regarding the enforceability of contract terms that disadvantage small businesses. The Federal Court's ruling on the unfairness of specific terms reinforces the need for transparency and fairness in standard-form contracts, especially those affecting small businesses. It also highlights the ACCC's active role in regulating unfair contractual practices under the Competition and Consumer Act 2010.

³⁸⁴ Hadfield (1990) 927-992.

Conclusion

The Federal Court declared 38 contract terms used by Fuji Xerox in agreements with small businesses as unfair. It further ordered the cessation of using these unfair terms in 11 standard-form contracts over the next five years.³⁸⁵

3. *ACCC v. Back in Motion Physiotherapy Pty Ltd*

Facts

The Australian Competition and Consumer Commission (ACCC) initiated proceedings against Back in Motion Physiotherapy Pty Ltd, a franchisor, alleging that specific terms in its franchise agreements were unfair. Specifically, the ACCC raised concerns regarding restrictive restraint of trade clauses and excessive penalties for franchisees who wished to exit the network. These clauses prohibited former franchisees from offering physiotherapy services within a 10-kilometer radius of any Back in Motion franchise for up to 12 months after leaving the network. The agreements also included streaming restraints with 21 possible clause variations, creating uncertainty and imposing significant burdens on franchisees. Franchisees wishing to be released from these restraint clauses had to pay a “buy-out fee” equivalent to four times their annual royalty fees, which presented further obstacles to exiting the system.

Legal Issue

Whether the restraint of trade clauses and associated “buy-out fee” in the franchise agreements were unfair under the Australian Consumer Law.

Decision/Holding

In 2020, Back in Motion Physiotherapy provided a court-enforceable undertaking to the ACCC, agreeing to amend the franchise agreements and stop enforcing the excessively restrictive restraint clauses.

The franchisor agreed to implement a narrower restraint provision, limiting it to a maximum of 9 months and restricting former franchisees only from actively soliciting clients of their former practice. The franchisor was also obligated to notify affected franchisees of these changes.

Reasoning

The Court and the ACCC found trade clause restraints excessively restrictive, particularly the franchisor's prohibition on former franchisees offering physiotherapy services in metropolitan areas for an extended period. The “buy-out fee” was deemed to impose significant financial burdens on franchisees wishing to exit the system.

Significance/Conclusion

³⁸⁵ Australian Competition and Consumer Commission v Fuji Xerox Australia Pty Ltd [2021] FCA 153.

The decision highlights the importance of establishing that franchise agreements do not impose unfair restrictions or excessively penalize franchisees, particularly regarding restraint of trade clauses and exit fees. The case resulted in a court-enforceable undertaking from Back in Motion Physiotherapy Pty Ltd to amend the restrictive provisions in its franchise agreements.³⁸⁶

Chapter Conclusion

The comparative analysis of franchise regulations across various jurisdictions highlights significant differences in the legal frameworks governing franchise agreements. Countries such as Germany and France have well-defined contractual principles that explicitly outline the rights and obligations of franchisors and franchisees, with judicial interpretation providing further clarity and enforcement.

Additionally, France, Italy, and Spain have implemented specialized franchise regulations alongside their civil codes, effectively preventing exploitative practices and ensuring fair treatment of franchisees. A key aspect of these legal frameworks is the establishment of clear pre-contractual disclosure obligations, requiring franchisors to provide essential information within a defined timeframe, typically 14 to 30 days before finalizing an agreement.

In North America, franchise regulations in Canada and the United States emphasize transparency, requiring franchisors to disclose a comprehensive list of documents and comply with a mandatory 14-day disclosure period. Similarly, the legal frameworks in England and Australia prioritize protections against unfair contract terms, contributing to a more balanced franchise relationship between franchisors and franchisees.

³⁸⁶ ACCC v. The Back in Motion Physiotherapy Pty Ltd.

THESIS CONCLUSION

I have reached the following conclusions based on a study on ‘Comparative analysis of franchising legal regulation in Mongolia.’ It includes;

1. Hypothesis that the Civil Code of Mongolia regulates franchise agreements in an overly general manner and lacks sufficient legal provisions

My study’s findings support the hypothesis that Mongolia’s Civil Code generally addresses franchise agreements and lacks sufficient legal provisions for effectiveness. While Chapter 29 of the Civil Code acknowledges franchise agreements within contract law, its framework remains underdeveloped, failing to provide the necessary specificity to address the complexities of franchising relationships.

One of the most significant shortcomings is the absence of a comprehensive definition of franchising and a precise categorization of franchise types. This regulatory gap creates uncertainty in legal interpretation, particularly in disputes involving undefined terms such as “franchise distributor,” “franchise appurtenant to the land,” and “master franchise.” Similarly, the undefined legal status of franchisors and franchisees further complicates the ability of individuals and entities to engage in franchise systems with legal certainty. This conclusion is supported by an in-depth analysis of the Civil Code’s franchise regulations, case study findings, and insights from interviews with legal experts specializing in contract law.

Another critical deficiency is the lack of differentiated regulations based on the nature of franchise agreements. While standard provisions are essential, the Civil Code does not account for variations in franchise relationships. Franchise agreements in Mongolia often contain strict contractual terms imposed by franchisors, yet the Civil Code does not provide adequate safeguards to establish fairness. Moreover, the study highlights the inadequate legal safeguards protecting franchisees from potentially exploitative contract terms. The general fairness regulation requiring parties to act reasonably toward each other is insufficient to prevent exploitative contract terms. Likewise, the broad and vague obligations imposed on franchisors and franchisees, such as the duty to exchange “mutually necessary documents,” lack clarity, leading to difficulties in compliance and enforcement.

The most concerning regulatory gap is the absence of mandatory pre-contractual disclosure requirements. The Civil Code does not specify the material facts franchisors must disclose to prospective franchisees or establish a timeline for such disclosures. Given the role of transparency in franchise relationships, this omission represents a fundamental weakness in Mongolia’s franchise regulation. To address this issue, it is probably essential to establish a mandatory disclosure framework, including a requirement for franchisors to provide relevant documents at least 14 days before the conclusion of a franchise agreement. Additionally, incorporating a specific list of mandatory disclosure items into the Civil Code would enhance legal certainty and validate prospective franchisees’ ability to access information before making contractual commitments.

Addressing these deficiencies through legislative reform, such as introducing more precise definitions, enhancing disclosure requirements, and strengthening franchisee protections, would contribute to a more comprehensive legal framework for franchising.

2. Hypothesis that examining comparative franchise regulation and conducting comparative studies can identify this regulatory gap

A comparative analysis of franchise regulations in various jurisdictions confirms that the legal framework governing franchise agreements in the Civil Code of Mongolia is insufficient and lacks the necessary safeguards to establish fair franchise relationships. Unlike Mongolia, countries such as Germany and France have well-defined contractual principles that explicitly regulate the rights and obligations of franchisors and franchisees, reinforced by judicial interpretation. Similarly, France, Italy, and Spain supplement their civil codes with specialized regulations that prevent exploitative practices. These jurisdictions also establish clear pre-contractual disclosure obligations, requiring franchisors to provide essential information within a specified timeframe, typically 14 to 30 days before finalizing the agreement.

Furthermore, franchise regulations in Canada and the United States impose stringent transparency requirements on franchisors, mandating a detailed list of disclosure documents and enforcing a 14-day disclosure period. Comparative research on English and Australian legal frameworks further underscores the advantages of regulations that prevent unfair contract terms, ensuring an excellent balance in franchise relationships.

Finally, my study demonstrates that Mongolia's franchise regulations, as currently outlined in the Civil Code, fall short of providing comprehensive protections for franchisees. The absence of precise disclosure requirements, insufficient safeguards against unfair contract terms, and the lack of explicit rights and obligations for franchisors and franchisees create legal uncertainty and potential vulnerabilities in franchise relationships. Based on these findings, this thesis proposes amendments to the Civil Code to enhance franchise regulations and place Mongolia's legal framework with international best practices.

PROPOSAL

PROPOSED AMENDMENT TO FRANCHISE CHAPTER IN THE MONGOLIAN CIVIL CODE

CHAPTER XXIX

338². Franchise Definition

(i) Franchise means a commercial arrangement where a franchisor or the franchisor's associate grants a franchisee the right to operate a business using the brand, trademarks, business model, and support services in exchange for fees or royalties.

(ii) Franchise System means the standardized method of operating a business, including trademarks, business practices, operational guidelines, and support provided by the franchisor to franchisees.

(iii) Franchise Agreement means a legal contract between the franchisor and franchisee that outlines the franchise relationship's rights, obligations, and terms, including fees, territories, and operational procedures.

(iv) Franchisor means the party that owns the franchise system and grants the right to operate a business using its brand, trademarks, and business model in exchange for fees or royalties.

(v) Franchisee means the party that operates a business under the franchisor's system, using the brand, trademarks, and support services and paying fees or royalties in return.

(vi) A Master Franchise agreement is a franchise agreement in which the franchisor grants a franchisee (the master franchisee) the right to sub-franchise the business and manage other franchisees within a specific territory or region.

(vii) Material Change means any significant modification in the franchise system's terms, conditions, or operations that could substantially affect the franchisee's rights, obligations, or value.

(viii) Material Fact means any information or fact that is significant enough to influence the decision-making of a prospective franchisee, including financial details, business performance, or operational requirements.

(ix) Misrepresentation means an untrue statement of a material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made.

338³. Right of the Franchisor

(i) The franchisor or the franchisor's associate has the right to exercise or exercises significant control over or has the right to provide or provide significant assistance in the franchisee's method of operation, including building design and furnishings, locations, business organization, marketing techniques, or training.

338⁴. Duty of the Franchisor

(i) Franchisors must provide franchisees with detailed and accurate information about the franchise items before entering into the franchise agreement. These disclosures must be written 14 days before the franchise agreement is signed. This includes:

- (a) Financial information such as estimated initial costs, ongoing fees, and the financial condition.
- (b) Business performance data and any relevant risks associated with the franchise.
- (c) The franchise system and support services offered by the franchisor.
- (d) Information about territory, supply chain arrangements, and any restrictions that apply to the franchisee.

338⁵. Right of the Franchisee

- (i) If a franchisee believes a franchise agreement term is unfair, they can challenge it in court or a tribunal. If the term is unfair, it will be declared void, meaning it cannot be enforced.
- (ii) Franchisees have the right to resolve disputes with the franchisor through mediation or arbitration before resorting to court action. The franchise agreement may require mediation as a first step before formal legal proceedings are pursued.

338⁶. Duty of the Franchisee

Franchisees must obey the terms and conditions outlined in the franchise agreement, including:

- (i) Compliance with the franchisor's operational procedures, guidelines, and marketing standards.
- (ii) Payment of any royalties, fees, and other financial obligations under the agreement.

(iii) Operating the franchise within the designated territory and following territorial restrictions if applicable.

338⁷. Term and Termination of the Franchisee

(i) The duration of the franchise agreement shall be for an initial term of at least 2 years, beginning from the date of execution of this agreement, unless earlier terminated according to the terms of this agreement.

(ii) The franchisee may request to renew the agreement for an additional term of years at least 6 months before the expiration of the initial term, subject to the franchisor's approval. Renewal shall be granted unless substantial reasons, such as a material breach of contract or failure to meet the franchisor's standards, justify the denial of renewal.

(iii) Upon termination of the agreement, the franchisee's right to use the franchisor's intellectual property, brand, and any proprietary business processes shall cease immediately, and the franchisee shall comply with the post-termination obligations outlined in the agreement.

APPENDIX

LAW OF MONGOLIA CIVIL CODE³⁸⁷

/This Code has been in effect since 2002/

CHAPTER TWENTY-NINE FRANCHISING, MERCHANDISING

Article 333. Franchising contract

333.1. Under the franchising contract, a franchisor shall undertake to transfer a license obtained according to established procedures and allow the use of nonmaterial property to a franchisee. The latter shall conduct activities by structures and cooperative programs agreed upon with the franchisor and pay proper fees or a specific part of revenues. Nonmaterial property shall include a company's name, trademark, product design, packaging, planning, management and communication, and primary goods and services procurement guidelines.

Article 334. Obligations of parties

334.1.A franchisor shall have the following obligations:

334.1.1.to protect a cooperation program from the involvement of third parties;

334.1.2.to regularly update the program;

334.1.3.to supply necessary information to the franchisee;

334.1.4.to provide technical assistance to the franchisee;

334.1.5.to offer training for franchisee's employees;

334.2.A franchisee shall have the following obligations:

334.2.1.to use rights and property received under contract productively and by purpose;

334.2.2.to pay fees and certain parts of revenue on time;

334.2.3.to ensure transferred rights and property in favor of the franchisor if provided by the contract;

334.2.4.not to transfer license and franchising to third party without franchisor's consent;

334.2.5.to involve own employees in training programs offered by the franchisor and bear respective expenses;

³⁸⁷ "See," in <https://legalinfo.mn/mn/detail/299>

334.2.6.to inform clients and customers that the franchisor trade name is being used under a license;

334.3. Parties shall exchange all necessary information if a contract is concluded and maintain the confidentiality of received information if an agreement is not concluded.

Article 335.Forms of franchising contract

335.1. Unless otherwise provided in law, a franchising contract shall be made in writing.

335.2. The franchising contract shall contain such basic terms as the contract duration, procedures of termination and extension of the agreement, obligations of parties, other necessary main conditions, and the program for franchise implementation.

Article 336.Duration of the franchising contract

336.1. Parties shall determine the duration of the franchising contract depending on the demand for a particular product or service and market share.

336.2. If the franchising contract was concluded for more than ten years, and the duration of the contract is not fixed, either party may terminate the agreement after 10 years within one year since notifying the other party of termination.

336.3. If the contract term expires, parties, guided by principles of mutual trust and business cooperation, may extend the contract for a definite or indefinite period on the same or renewed terms at the initiative of either party until their business relationship ends.

Article 337. Limiting competition

337.1. Upon the expiration of the franchising contract, the franchisor shall have the right to prohibit the franchisee's successor from competing in a specific territory for up to one year.

337.2. If this prohibition stated in article 337.1 of this law causes severe damage to the main business of the franchisee, the franchisor shall award reasonable compensation to the franchisee.

Article 338. Mutual liabilities of parties

338.1. Parties shall be liable for the implementation of contractual obligations and the accuracy of information provided.

338.2. The franchisee shall be obligated to compensate for damage and expenses caused to the franchisor about obligations under the franchising contract

338.3. The franchisor shall not be obliged to issue any guarantee of possible revenues the franchisee may earn under the franchising contract.

338.4. The franchisor is not liable for any damage caused to clients by a franchisee's conduct.

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