



# ICLG

The International Comparative Legal Guide to:

## Franchise 2019

**5th Edition**

A practical cross-border insight into franchise law

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Anand and Anand

Anderson Mōri & Tomotsune

Arias, Charua, Macías & Prum, S.C.

Badertscher Rechtsanwälte AG

British Franchise Association

Bustaman

Cassels Brock & Blackwell LLP

Christodoulou & Mavrikis Inc.

Daniel Legal & IP Strategy

DLA Piper UK LLP

Grupo Gispert Abogados & Economistas

Hamdan AlShamsi Lawyers & Legal Consultants

Hannes Snellman Attorneys Ltd

Horten Advokatpartnerselskab

International Franchise Association

Jones & Co.

LINKEA

Marsh & Maher Richmond Bennison Lawyers

Noerr

Pehlivan & Güner

Polsinelli PC

Rödl & Partner

SCA RUBIN MEYER DORU & TRANDAFIR

Stewart Germann Law Office

The Richard L. Rosen Law Firm, PLLC

TLT LLP





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**Group Consulting Editor**  
Alan Falach

**Publisher**  
Rory Smith

**Published by**  
Global Legal Group Ltd.  
59 Tanner Street  
London SE1 3PL, UK  
Tel: +44 20 7367 0720  
Fax: +44 20 7407 5255  
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# South Africa

Christodoulou & Mavrikis Inc.

Alex Protulis



## 1 Relevant Legislation and Rules Governing Franchise Transactions

### 1.1 What is the legal definition of a franchise?

“Franchise” is not defined in terms of South African law. However, in terms of the Franchise Association of South Africa, “franchise” is defined as giving an individual the “right” to something – in this case the right to operate a business or licence under specific conditions.

### 1.2 What laws regulate the offer and sale of franchises?

The Consumer Protection Act No. 68 of 2008 (“CPA”), the CPA Regulations and common law regulate the offer and sale of franchises.

### 1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

No, they will not.

### 1.4 Are there any registration requirements relating to the franchise system?

No, there are no registration requirements relating to franchise systems.

### 1.5 Are there mandatory pre-sale disclosure obligations?

Yes, Regulation 3 of the CPA Regulations deals with disclosure documents for prospective franchisees. A franchisor has a duty, at least 14 days prior to the signing of a franchise agreement, to provide a potential franchisee with certain disclosure information. See question 1.7 below for the prescribed format of the pre-sale disclosure obligations.

### 1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

Yes, pre-sale disclosure obligations apply to sales to sub-franchisees as well and such an obligation rests on the master franchisee to comply with.

### 1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

Regulation 3 of the CPA Regulations states:

- (1) Every franchisor must provide a prospective franchisee with a disclosure document, dated and signed by an authorised officer of the franchisor, at least 14 days prior to the signing of a franchise agreement, which as a minimum must contain:
  - (a) the number of individual outlets franchised by the franchisor;
  - (b) the growth of the franchisor’s turnover, net profit and the number of individual outlets, if any, franchised by the franchisor for the financial year prior to the date on which the prospective franchisee receives a copy of the disclosure document;
  - (c) a statement confirming that there have been no significant or material changes in the company’s or franchisor’s financial position since the date of the last accounting officer, or auditor’s certificate or certificate by a similar reviewer of the company or franchisor, that the company or franchisor has reasonable grounds to believe that it will be able to pay its debts as and when they fall due; and
  - (d) written projections in respect of levels of potential sales, income, gross or net profits or other financial projections for the franchised business or franchises of a similar nature with particulars of the assumptions upon which these representations are made.
- (2) Each page of the disclosure document contemplated in sub-regulation (1) above must be qualified in respect of the assumptions contained therein.
- (3) The disclosure document contemplated in sub-regulation (1) above must be accompanied by a certificate on an official letterhead from a person eligible in law to be registered as the accounting officer of a close corporation, or the auditor of a company, as the case may be, certifying that:
  - (a) the business of the franchisor is a going concern;
  - (b) to the best of his or her knowledge, the franchisor is able to meet its current and contingent liabilities;
  - (c) the franchisor is capable of meeting all of its financial commitments in the ordinary course of business as they fall due; and
  - (d) the franchisor’s audited annual financial statements for the most recently expired financial year have been drawn up:
    - (i) in accordance with South African generally accepted accounting standards;

- (ii) except to the extent stated therein, on the basis of accounting policies consistent with prior years;
  - (iii) in accordance with the provisions of the Companies Act No. 61 of 1973 (or any legislation which replaces this Act), and all other applicable laws; and
  - (iv) fairly reflecting the financial position, affairs, operations and results of the franchisor as at that date and for the period to which they relate.
- (4) The disclosure document contemplated in sub-regulation (1) above must be accompanied by:
- (a) a list of current franchisees, if any, and of outlets owned by the franchisor, stating, in respect of any franchisee:
    - (i) the name under which it carries on business;
    - (ii) the name of its representative;
    - (iii) its physical address; and
    - (iv) its email and office telephone number, together with a clear statement that the prospective franchisee is entitled to contact any of the franchisees listed, or alternatively to visit any outlets operated by a current franchisee to assess the information disclosed by the franchisor and the franchise opportunity offered by it; and
  - (b) an organogram depicting the support system in place for franchisees.

The financial disclosure obligations listed under sub-regulations (1) to (3) above must be updated on an annual basis. A franchisor is obliged to update sub-regulation (4) on a continual basis, as and when a new franchised business is sold, or when any information changes.

There is no obligation to make continuing disclosure to existing franchisees; only to potential franchisees.

#### **1.8 Are there any other requirements that must be met before a franchise may be offered or sold?**

There are no compulsory obligations that a franchisor must comply with before a franchise may be offered or sold. However, it would be beneficial for a franchisor to have registered its trade marks or to have lodged an application for the registration of its trade marks with the Companies and Intellectual Properties Commission (“CIPC”) prior to marketing the franchise system to potential franchisees.

#### **1.9 Is membership of any national franchise association mandatory or commercially advisable?**

No; membership to the Franchise Association of South Africa (“FASA”) is not mandatory but is deemed to be commercially advisable as it aims to promote ethical franchising in South Africa and conforms to international best practices.

#### **1.10 Does membership of a national franchise association impose any additional obligations on franchisors?**

Yes, all members of FASA, including but not limited to franchisors, franchisees and professional service providers, need to adhere to FASA’s Code of Ethics and Business Practices. In addition, franchisors need to comply with FASA’s Disclosure Documents Requirements. Both these documents may be viewed at:

- <https://www.fasa.co.za/documents/CodeOfEthics20170811.pdf>.
- <https://www.fasa.co.za/documents/DisclosureDocumentRequirements14112011.pdf>.

It is worth noting that FASA is in the process of reviewing its Code of Ethics and Business Practices in order to simplify its policies.

#### **1.11 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?**

There is no statutory requirement that franchise documents or disclosure documents need to be translated into the local language. However, in terms of FASA’s Disclosure Documents Requirements, FASA requires disclosure documents and supporting documents to be in English.

## **2 Business Organisations Through Which a Franchised Business can be Carried On**

#### **2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?**

No, there are no such laws.

#### **2.2 What forms of business entity are typically used by franchisors?**

Franchisors most commonly operate through companies (private or public) and close corporations. International franchisors may conduct business in South Africa through external companies (branches).

As international franchisors look to expand into South Africa, franchise joint ventures are growing in popularity as international franchisors are able to establish networks with local partners but still keep control of their brands.

Alternatively, international franchisors are also granting local partners the rights to master franchisees for the whole of South Africa or particular regions in South Africa.

#### **2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?**

All new companies (local and external) need to be registered at the Companies and Intellectual Properties Commission before they commence trading.

## **3 Competition Law**

#### **3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.**

The Competition Act No. 89 of 1998 applies to franchising as it constitutes an economic activity within the Republic of South Africa. However, as franchising appears to “infringe” on several clauses of the Competition Act, the Competition Commission issued a Franchising Notice to clarify the Competition Commission’s stance on franchising.

Accordingly, the Competition Commission concluded that: “Franchising agreements are as such not necessarily

anticompetitive. They are used to establish a distribution network and this creates opportunities and benefits to both parties. The franchisor exploits expertise in other markets without substantial capital investment in setting up a retail network. The franchisee, on the other hand, also gets access to trading methods, which have been tried and tested. Therefore, any agreement that is necessary to support the essential features of the franchise relationship should not raise competition concerns, for example, the protection of the know-how, protection of network reputation, or selective distribution clauses which are normally introduced for efficiency reasons.”

### 3.2 Is there a maximum permitted term for a franchise agreement?

No. In practice, franchise agreements run for a period of five years, with an option to renew for a further five-year period.

### 3.3 Is there a maximum permitted term for any related product supply agreement?

No, there is not.

### 3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Yes; in terms of section 5(2) of the Competition Act, the practice of minimum resale price maintenance is prohibited. However, in terms of section 5(3), a supplier or producer may recommend a minimum resale price to the reseller of a good or service, provided:

- (a) the supplier or producer makes it clear to the reseller that the recommendation is not binding; and
- (b) if the product has its price stated on it, the words “recommended price” appear next to the stated price.

### 3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

There is no statutory protection afforded to a franchisee against its franchisor or second franchisee for competing within the same territory allocated to the said franchisee in terms of its franchise agreement. In terms of the CPA Regulations, any territorial rights granted to a franchisee need to be specifically included in the franchise agreement. Therefore, the franchisee may have a claim against the franchisor for breach of contract.

### 3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Yes, both in-term and post-term non-compete (restraint of trade) and non-solicitation of customers’ covenants are enforceable by our courts provided they are reasonable and not contrary to public policy.

An injunction granted by a foreign court is not directly enforceable in South Africa but constitutes a cause of action. Therefore, in order for a foreign judgment to be recognised and enforced by South African courts, the following conditions need to be fulfilled:

- the foreign court had jurisdiction to hear the case;
- judgment is final and conclusive in its effect and has not become superannuated;
- the recognition and enforcement of the judgment by South African courts would not be contrary to public policy;
- the judgment was not obtained fraudulently;

- the judgment does not involve the enforcement of a penal or revenue law of the foreign state; and
- the enforcement of the judgment is not precluded by the provisions of the Protection of Businesses Act No. 99 of 1978.

## 4 Protecting the Brand and other Intellectual Property

### 4.1 How are trade marks protected?

Registered trade marks are protected and defended under the Trade Marks Act No. 194 of 1993, whilst unregistered trade marks may only be defended in terms of common law.

The CIPC administers the Register of Trade Marks in the Republic of South Africa.

Applicants have to file a separate trade mark application for each international class of goods or services for which it would like to use the trade mark. The registration procedure results in a registration certificate which has legal status, allowing the owner of the registered trade mark the exclusive right to use that mark.

Registered trade marks can be protected forever, provided they are renewed every 10 years upon payment of the prescribed renewal fee to the CIPC. The CIPC will notify a trade mark owner/holder six months before a renewal is due, but ultimately the onus to renew rests on the owner/holder of the trade mark.

Failure to protect one’s trade mark may result in a third party passing off his goods or services with the goods or services of the trade mark owner.

### 4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Yes, know-how, trade secrets and other business-critical confidential information is protected in terms of common law and law of contracts.

A party may launch an application to court in order to interdict a person who has unlawfully used the know-how, trade secrets and confidential information of another.

### 4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

Yes; copyright in South Africa is governed by the Copyright Act No. 98 of 1978 and is administered by the CIPC. South Africa is also a party to the Berne Convention and the Agreement on Trade-Related Aspects of Intellectual Property Rights (“TRIPS Agreement”). In addition, South Africa has signed, but not ratified, the World Intellectual Property Organization (“WIPO”) Copyright Treaty.

## 5 Liability

### 5.1 What are the remedies that can be enforced against a franchisor for failure to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

Yes; a franchisee may be entitled to rescind a franchise agreement

and/or claim damages if a franchisor fails to comply with its mandatory disclosure obligations.

In terms of section 52(4)(a)(i)(bb) of the CPA:

- (1) If, in any proceedings before a court concerning a transaction or agreement between a supplier (franchisor) and a consumer (franchisee), a person alleges that an agreement, a term or condition of an agreement, or a notice to which a transaction or agreement is purportedly subject, is void in terms of this Act or failed to satisfy any applicable requirements set out in section 49, the court may:
  - (a) make an order:
    - (i) in the case of a provision or notice that is void in terms of any provision of this Act:
      - (aa) severing any part of the relevant agreement, provision or notice, or altering it to the extent required to render it lawful, if it is reasonable to do so having regard to the transaction, agreement, provision or notice as a whole;
      - (bb) declaring the entire agreement, provision or notice void as from the date that it purportedly took effect; or
    - (ii) in the case of a provision or notice that fails to satisfy any provision of section 49, severing the provision or notice from the agreement, or declaring it to have no force or effect with respect to the transaction; and
  - (b) make any further order that is just and reasonable in the circumstances with respect to that agreement, provision or notice, as the case may be.

The National Consumer Tribunal may impose an administrative fine on a franchisor if the franchisor is found guilty of non-compliance, which fine may not exceed the greater of 10 per cent of the franchisor's annual turnover or up to R 1 million (one million Rand).

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**5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?**

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No; in terms of sub-franchising, the master franchisee is responsible for complying with the disclosure obligations. In order to protect itself from any liability due to disclosure non-compliance or pre-contractual misrepresentation, the franchisor should obtain an indemnity from the master franchisee indemnifying itself from this obligation.

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**5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including disclaimer clauses in the franchise agreement?**

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No; a franchisor may not contract out of the CPA in order to evade liability for pre-contractual misrepresentation.

In terms of section 48(1)(c) of the CPA:

- (1) A supplier (franchisor) must not:
  - (a) require a consumer (franchisee), or other person to whom any goods or services are supplied at the direction of the consumer:
    - (i) to waive any rights;
    - (ii) assume any obligation; or
    - (iii) waive any liability of the supplier,

on terms that are unfair, unreasonable or unjust, or impose any such terms as a condition of entering into a transaction.

Furthermore, in terms of common law, a franchisor cannot contract out of liability for misrepresentation.

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**5.4 Does the law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?**

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In terms of section 4(1)(c) of the CPA, class actions are permissible in terms of South African law, and therefore class action waiver clauses would be deemed to be unenforceable as one may not contract out of the CPA. As class actions are still gaining traction in our legal system, class actions by franchisees have not yet tested our courts.

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## 6 Governing Law

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**6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?**

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Generally, franchise agreements concluded in South Africa are governed by the local law; however, if a franchisor is located outside of South Africa, there is nothing precluding it from electing its own governing law to govern the franchise agreement. In other words, contracting parties have freedom of choice as to which laws they intend to govern their contracts.

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**6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a rogue franchisee to prevent damage to the brand or misuse of business-critical confidential information?**

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A franchisor may seek urgent injunctive relief against a rogue franchisee by way of an interdict. An interdict is sought by way of a court application and may either be a prohibitory interdict (i.e. prevents the rogue franchisee from doing something) or a mandatory interdict (i.e. requires the rogue franchisee to do something).

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**6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Award? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?**

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In South Africa, arbitration has always been considered an expensive alternative to civil litigation. However, the International Arbitration Act No. 15 of 2017 ("the IAAA") recently came into operation on 20 December 2017 and incorporates the United Nations Commission on International Trade Law ("UNCITRAL") Model Law into South African law. As a result, the IAAA ensures that South Africa now has a reformed and modernised international arbitration law which will assist South African businesses to resolve their disputes in a speedy and cost effective manner.

South Africa has acceded to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

There is no mandatory obligation to engage in mediation before commencing formal arbitration or court proceedings.

## 7 Real Estate

### 7.1 Generally speaking, is there a typical length of term for a commercial property lease?

The lease term for a commercial property is usually five or 10 years, with an option to renew for a further five- or 10-year period, depending on the performance of the tenant.

There is no statutory right to enable a tenant to hold over the tenancy at the end of the contract term. In the event that a tenant does hold over, the tenancy will continue on a month-to-month basis and the tenant will be obliged to continue to pay its rent, will remain bound by all the terms and conditions of the tenancy and will also be liable to the landlord for any damages that the landlord may suffer as a result of the tenant's continued occupation of the leased premises.

### 7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant's shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Such a concept will only be enforceable if it is contained in the lease agreement. It is common practice for landlords to specify in a lease agreement that the leased premises are reserved for a particular type of franchise, thus affording the franchisor the opportunity to step into the franchisee's shoes under the lease or to appoint a replacement franchisee to take over the lease.

Franchisors usually include a condition in the franchise agreement that the franchisee must negotiate and include such a clause in its lease agreement.

### 7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

There are no restrictions on non-nationals (natural or juristic persons) from holding an interest in or sub-letting immovable property in South Africa.

### 7.4 Give a general overview of the commercial real estate market. Specifically, can a tenant reasonably expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding "key money" (a premium for a lease in a particular location)?

Whilst the commercial real estate market in urban areas is fairly saturated, there are still major investment opportunities for retail development in highly populated, previously disadvantaged areas of South Africa.

Tenants usually expect to secure an initial rent-free period ("beneficial occupation") when concluding a new lease with a landlord. Beneficial occupation may be anything between one and three months.

Even though it is legal to do so, it is not common practice for landlords to demand "key money" for a specific location.

## 8 Online Trading

### 8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee's exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

Yes, a franchise agreement may impose binding requirements for a request to be re-directed to the franchisee of a particular territory. As franchising is subject to the same competition laws and policies applicable to all other economic activities, the Competition Commission has held that a franchisor is allowed to engage in exclusive territory arrangements if the aim is to achieve efficiencies in distribution.

### 8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No, unless such a provision is recorded in the franchise agreement.

## 9 Termination

### 9.1 Are there any mandatory local laws that might override the termination rights that one might typically expect to see in a franchise agreement?

There are no mandatory local laws that may override a franchisor's right to terminate a franchise agreement.

### 9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that might have existed for a number of years to an end, which will apply irrespective of the length of the of notice period set out in the franchise agreement?

There are no local rules imposing a minimum notice period to be given to end a business relationship. The notice period will be governed by the time period agreed to in the franchise agreement.

## 10 Joint Employer Risk and Vicarious Liability

### 10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee's employees? If so, can anything be done to mitigate this risk?

The question of when or whether a franchisor may be considered a joint employer of the franchisee's employees centres around the issue of "control". The current law, as stated in *SA Broadcasting Corporation v McKenzie (1999) 20 ILJ 585 (LAC)*, draws a distinction between "employees" and "independent contractors", which are defined as follows:

Employee:

- the object is the rendering of personal services between the employer and employee;
- an employee renders the service at the request of the employer;
- an employer decides whether it wishes to have an employee render the service;
- an employee is obliged to obey lawful, reasonable instructions regarding the work to be done and the manner in which it is to be done;
- a contract of employment is terminated by the death of the employee; and
- a contract of employment terminates on completion of the agreed period.

Independent contractor:

- the object is the production of a certain specified service or the production of a certain specified result;
- an independent contractor is not obliged to perform his work personally, unless otherwise agreed;
- an independent contractor is bound to perform specified work or produce a specified result within a specified or reasonable time;
- an independent contractor is not obliged to obey instructions regarding the manner in which a task is to be performed;
- the contract of work is not terminated by the death of the contractor; and
- the contract of work terminates on completion of the specified work, or on production of the specified result.

When a franchisor crosses the boundary of what defines an independent contractor, then it may be seen to be an employer-employee relationship.

However, in order to prevent a franchisor from being regarded as a joint employer with a franchisee, in respect of the franchisee's employees, a franchisor should insert a "no employer-employee relationship" clause in its franchise agreement.

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### **10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee's employees in the performance of the franchisee's franchised business? If so, can anything be done to mitigate this risk?**

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No, a franchisor cannot be held vicariously liable for the acts or omissions of a franchisee and/or the franchisee's employees.

The test to determine whether an employer may be held vicariously liable for the delict (tort) of his employee is as follows:

- there must have existed an employer-employee relationship when the delict was committed;
- the employee must have committed the delict; and
- the employee must have acted within the scope of his employment when the delict was committed.

Therefore, in order to limit the risk of a franchisor being held vicariously liable for the acts or omissions of a franchisee's employees, franchisors should insert a "no employer-employee relationship" clause in their franchise agreements.

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## **11 Currency Controls and Taxation**

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### **11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?**

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South African franchisees are obliged to obtain exchange control approval from the South African Reserve Bank before making any outward royalty payments to non-resident franchisors.

In terms of subsection 10.7 of the South African Reserve Bank Currency and Exchange Guidelines for Business Entities (22-06-2018):

- prior to effecting payment, South Africa franchisees must furnish an authorised dealer (the franchisee's local bank) with a copy of the franchise agreement it concluded with the non-resident franchisor and present invoices verifying the purpose and the amount involved from the non-resident franchisor; and
- where a South African franchisee makes recurring royalty payments, it must present a letter from an independent auditor to the authorised dealer on an annual basis, in respect of the royalty payments, confirming the amount or percentage transferred over a 12-month period.

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### **11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?**

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In terms of the South African Revenue Service, Withholding Tax on Royalties ("WTR") is due on any amount of royalty paid to or for the benefit of a foreign franchisor from a source within South Africa.

Royalties paid by a franchisee are taxed at a final withholding tax rate of 15 per cent.

The foreign franchisor is liable for the tax, but the tax must be withheld from the royalty payment by the person paying it to the foreign franchisor (i.e. the withholding agent).

A royalty is any amount that is received or accrues in respect of:

- the use, right of use or permission to use any intellectual property;
- imparting or undertaking to impart any scientific, technical, industrial or commercial knowledge or information; or
- rendering or undertaking to render any assistance or service in connection with the application or utilisation of that knowledge or information.

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### **11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?**

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There are no such requirements under South African law.

## 12 Commercial Agency

### 12.1 Is there a risk that a franchisee might be treated as the franchisor's commercial agent? If so, is there anything that can be done to help mitigate this risk?

Yes, it is possible that a franchisee may be treated as a franchisor's commercial agent. Therefore, in order to limit this risk, franchisors should insert a "no partnership or agency" clause in their franchise agreements.

## 13 Good Faith and Fair Dealings

### 13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

In terms of South African law, the concept of good faith is applicable to all contracts. Furthermore, the following fundamental consumer rights are set out in Chapter 2 of the CPA:

Part F: Right to fair and honest dealing

Section 40: Unconscionable conduct

- (1) A supplier (franchisor) or an agent of the supplier must not use physical force against a consumer (franchisee), coercion, undue influence, pressure, duress or harassment, unfair tactics or any other similar conduct, in connection with any:
  - (a) marketing of any goods or services;
  - (b) supply of goods or services to a consumer;
  - (c) negotiation, conclusion, execution or enforcement of an agreement to supply any goods or services to a consumer;
  - (d) demand for, or collection of, payment for goods or services by a consumer; or
  - (e) recovery of goods from a consumer.
- (2) In addition to any conduct contemplated in subsection (1), it is unconscionable for a supplier knowingly to take advantage of the fact that a consumer was substantially unable to protect the consumer's own interests because of physical or mental disability, illiteracy, ignorance, inability to understand the language of an agreement, or any other similar factor.

Therefore, a franchisor must act fairly and in good faith in its dealings with franchisees.

## 14 Ongoing Relationship Issues

### 14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

Yes; Part G of the CPA deals with a consumer's (franchisee's) right to fair, unreasonable or unjust contract terms and conditions and states:

"Section 48: Unfair, unreasonable or unjust contract terms

- (1) A supplier (franchisor) must not:
  - (a) offer to supply, supply, or enter into an agreement to supply, any goods or services:

- (i) at a price that is unfair, unreasonable or unjust; or
  - (ii) on terms that are unfair, unreasonable, or unjust;
- (b) market any goods or services, or negotiate, enter into or administer a transaction or an agreement for the supply of any goods or services, in a manner that is unfair, unreasonable or unjust; or
  - (c) require a consumer, or other person to whom any goods or services are supplied at the direction of the consumer:
    - (i) to waive any rights;
    - (ii) assume any obligation; or
    - (iii) waive any liability of the supplier;

on terms that are unfair, unreasonable or unjust, or impose any such terms as a condition of entering into a transaction.

- (2) Without limiting the generality of subsection (1), a transaction or agreement, a term or condition of a transaction or agreement, or a notice to which a term or condition is purportedly subject, is unfair, unreasonable or unjust if:
  - (a) it is excessively one-sided in favour of any person other than the consumer or other person to whom goods or services are to be supplied;
  - (b) the terms of the transaction or agreement are so adverse to the consumer as to be inequitable;
  - (c) the consumer relied upon a false, misleading or deceptive representation, as contemplated in section 41 or a statement of opinion provided by or on behalf of the supplier, to the detriment of the consumer;
  - (d) the transaction or agreement was subject to a term or condition, or a notice to a consumer contemplated in section 49(1), and:
    - (i) the term, condition or notice is unfair, unreasonable, unjust or unconscionable; or
    - (ii) the fact, nature and effect of that term, condition or notice was not drawn to the attention of the consumer in a manner that satisfied the applicable requirements of section 49."

Regulation 2 of the CPA deals with the minimum requirements of what must be contained in a franchise agreement.

In terms of Regulation 2(3)(m) of the CPA, if a franchise agreement provides that a franchisee must directly or indirectly contribute to an advertising, marketing or other similar fund, the franchisor must:

- (i) within six months after the end of the last financial year, provide a franchisee with a copy of a financial statement, prepared in accordance with applicable legislation, which fairly reflects the fund's receipts and expenses for the last financial year, including amounts spent, and the method of spending on advertising and/or marketing of franchisees and the franchise system's goods and services; and
- (ii) for every three-month period, make financial management accounts relating to the funds available to franchisees.

## 15 Franchise Renewal

### 15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

There are no disclosure obligations applicable to the renewal of existing franchise agreements; only to new franchise agreements. However, it is advisable for franchisors to provide updated

disclosure documents to franchisees upon the renewal of an existing franchise agreement.

**15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?**

There is no overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term. Franchisors usually look at the performance of a franchisee during the initial term to determine whether or not to renew the term.

**15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?**

Yes, a franchisee who is not in breach of its franchise agreement would be entitled to either:

- claim damages; or
- claim specific performance (i.e. renew the franchise agreement in terms of the renewal period) from the franchisor.

## 16 Franchise Migration

**16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?**

Yes, such restrictive provisions are enforceable if recorded in the franchise agreement. Usually a franchise agreement will contain a provision that a franchisee may not transfer the franchised business in any manner whatsoever without the prior written consent of the franchisor.

**16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?**

Yes, "step-in" rights are recognised and enforceable by our courts provided that such rights are recorded in the franchise agreement.

There are no registration requirements or other formalities that need to be complied with to enforce such rights.

**16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or "step-in" rights, will such a power of attorney be recognised by the courts in the country and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?**

If a franchise agreement contains such a power of attorney, it will

be recognised and enforceable in terms of South African law. No registration or other formalities must be complied with in order for the power of attorney to be valid and effective.

## 17 Electronic Signatures and Document Retention

**17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a "wet ink" version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?**

Section 7(1)(a) of the CPA states that a franchise agreement must be in writing and signed by or on behalf of the franchisee.

In South Africa, electronic signatures are regulated by both the common law and the Electronic Communications and Transactions Act No. 25 of 2002 ("ECTA").

ECTA makes provision for two types of electronic signatures, namely "standard electronic signatures" and "advanced electronic signatures".

A standard electronic signature means data attached to, incorporated in, or logically associated with other data and which is intended by the user to serve as a signature.

Advanced electronic signature means an electronic signature which results from a process which has been accredited by an accreditation authority.

Section 13 of ECTA specifically states that where the signature of a person is required by law and such law does not satisfy the type of signature, that requirement in relation to a data message is met only if an advanced electronic signature is used. An electronic signature is not without legal force and effect merely on the grounds that it is in electronic form. Furthermore, where an advanced signature has been used, such signature is regarded as being a valid electronic signature and to have been applied properly, unless the contrary is proved.

Therefore, in order to conclude a valid and binding franchise agreement by way of an electronic signature in South Africa, the franchisee would need to sign the franchise agreement with an advanced electronic signature.

**17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a "wet ink" version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?**

The CPA does not prescribe a time period for the retention of a franchise agreement. However, the South African Revenue Service requires a person to keep records, books of account or documents for a minimum period of five years.

Where an original agreement has been lost or destroyed, a person may rely on a copy of an agreement by adducing secondary evidence of its conclusion and terms.

However, it would be prudent to retain the original franchise agreement, even if a version has been scanned and saved as an electronic file, especially for litigation purposes.

**Alex Protulis**

Christodoulou & Mavrikis Inc.  
Suite 3A, 5 Fricker Road  
Illovo, Johannesburg  
2196  
South Africa

*Tel:* +27 11 325 4201  
*Email:* alex@cm-attorneys.com  
*URL:* www.cm-attorneys.com

Alex is a Partner at Christodoulou & Mavrikis Inc. and specialises in commercial law, franchise law, commercial litigation and cyber law.

Alex is a dual-qualified lawyer and is admitted in South Africa and England & Wales (non-practising). He began his career as a Candidate Attorney at Christodoulou & Mavrikis Inc. in 2005. Upon qualifying in 2007, Alex moved to London to pursue his legal career in the United Kingdom. During his time overseas, Alex undertook the Qualified Lawyers Transfer Test and was admitted as a solicitor in 2009, and worked for renowned international law firms where he was involved in all aspects of regulatory and legal compliance issues.

Alex rejoined Christodoulou & Mavrikis Inc. in 2012 and represents various franchisors in the food and beverage industry.



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Christodoulou & Mavrikis Inc. is a full-service South African corporate and commercial law firm, established in Johannesburg in 1991. The firm is ideally placed to deal with franchise law, both local and international mergers and acquisitions, commercial law, commercial litigation and dispute resolution.

Franchise law services include competition law aspects, confidentiality and non-competition agreements, the Consumer Protection Act and how it affects franchise agreements, drafting of franchise agreements, franchise disputes, licensing agreements, operations manuals and trade mark and intellectual property registrations. Although the majority of our clients are franchisors in the food and beverage industry, due to our extensive knowledge our lawyers are able to provide expert legal advice in all areas of franchising law to all industry participants.

The firm is an approved professional service provider member of the Franchise Association of South Africa.

An international branch office has operated in Athens, Greece since 2004, which is managed by Mr. George Mavrikis.

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59 Tanner Street, London SE1 3PL, United Kingdom  
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255  
Email: [info@glgroup.co.uk](mailto:info@glgroup.co.uk)