

Aspects of Franchising Law in Israel

Peggy Sharon, Adv. and Inbal Natan-Zehavi, Adv.

Introduction

The franchising phenomenon started in the United States and Europe; however it is not geographically limited thereto and is now a growing part of Israel's economy and in recent years has become a significant part of the market. Over two hundred and fifty franchised small-medium businesses are operating in Israel, in thirty seven different areas of business^[1]. The most dominant franchise businesses in Israel are in the fields of: Beverage & Alcohol, Fast Food, Retail Food Industry, Real Estate, Life style, Cosmetics & Health, Pets, Clothing and Accessories. The fact that more and more large corporations revert to franchising for promoting and expanding their operations has indeed influenced the entire market, however franchising is no longer in the hold of large corporations. Small medium sized businesses also use this structure to expand their operations with only a small number of branches. At the same time, one might find corporations such as: "McDonald's", "Domino's Pizza" (Fast Food), "Zara", "Mango" (fashion & clothing), "Remax" (Real Estate), "Toys-R-Us" (Children) - with dozens of branches all over Israel - all using the franchise implementation.

A. Legal Framework

The franchising agreement is not governed by any direct Israeli law, and hence is primarily governed by the Contracts Law (General Part) 1973. This law sets the provisions relating to contracts in general, i.e. pre-contractual duties of good faith, offer and acceptance, performance of undertakings, interpretations, etc. The duty of good faith both in the negotiations for the conclusion of the contract and in the performance of the respective obligations of the parties is the most significant principle introduced by this law to the Israeli legal system. Other laws which are relevant to franchise agreements, are the Contracts Law (Remedies for Breach of Contracts) 1971, the Companies Law 1999, and the Law on Commercial Wrongs 1999.

However, the term "franchise" is expressly referred to and defined within the scope of Regulations which have provided an exclusion from the applicability "The Restrictive Trade Practices Law - 1988" (hereinafter: **the Anti-Trust Law**), which applies to restrictive arrangements, monopoly and amalgamation of companies. As will be demonstrated below, a definition and a description of the characteristics of the franchise agreement is included within the Anti-trust Rules (Exemption of Franchising Agreement) 2001.

A.1. The Restrictive Arrangement as Defined by the Anti-Trust Law

According to the Anti-Trust Law, any agreement in which the parties restrict the possible business competition between the parties to the agreement or between any of them to others - is illegal. The Anti-Trust Law refers to such an agreement as a "Restrictive Arrangement" and defines it as follows:

"Article One: A Restrictive Arrangement Defined

2. (a) *A restrictive arrangement is an arrangement made between persons who manage businesses, according to which at least one of the parties imposes a restriction on himself which is liable to prevent or to reduce business competition between himself and all or some of the other parties to the arrangement, or between himself and a person who is not party to the arrangement.*

(b) *Without derogating from the generality of the provisions of sub-section (a), any arrangement according to which the restriction applies to one of the following shall be deemed a restrictive arrangement:*

- (1) *the price to be asked, offered or paid;*
- (2) *the profit to be produced;*
- (3) *division of all or part of the market, by place of business or by the people or categories of people with whom business is to be transacted;*
- (4) *the quantity, quality or category of assets or services in the business."*

However, according to the Law, notwithstanding the above definition, various arrangements will not be considered as restrictive arrangements such as: the use of a patent, design or trademark, real estate transfer with restrictions on the purchaser to deal with real estate, cultivation of agricultural products, an agreement between a company and its subsidiary, international sea or air transportation agreements, employment working conditions, etc.

A.2. The Results of Restrictive Arrangements

The Law prohibits restrictive arrangements, unless such arrangements have received approval from the Court of a permit or of an exemption from the applicability of the Law.

In the absence of such approval, any party to a restrictive arrangement may be liable to criminal proceedings, and also any act in contravention of the Law will be considered as a civil wrong under the Tort Ordinance and lead to civil remedies imposed thereby.

A.3. Franchising Agreement - Specific Exemption

"52. The minister may, after consultation with the Knesset Economic Committee exempt a restrictive business practice from all or some provisions of this Law, if he believes that to be necessary for reasons of foreign policy or national security."

According to specific regulations (rules) which were enacted by the Ministry of Trade and Industry and by the Anti-Trust Commissioner in 2001, the Minister gave an exemption to franchising agreements from the applicability of the Anti-Trust Law.

According to these rules, "**the Anti-Trust Rules (Exemption of Franchising Agreement) 2001**", a franchising agreement is defined as follows:

"Franchising Agreement - an agreement according to which the owner of the franchise or a principal franchisor grants a franchisee the right to use a franchise for the purpose of marketing of goods or of types of certain goods which includes all the following:

- 1. The use of a uniform trade name or trademark or a uniform service mark and with uniform characteristics of the goods sold or of the sale and its performance which are material to the marketing of the goods and its sale.*
- 2. The transfer of know how from the franchisor to the franchisee which is material to the marketing and sale of the goods.*
- 3. Granting commercial or technical assistance by the franchisor to the franchisee during the period of the agreement."*

In these rules, "Franchise" is defined as:

"The giving of the right to use intellectual property or industrial know how either where they are protected by a trade mark, mark of service, copyright, patent,...or another protection of intellectual property or where they are characterized as a commercial name, design or special models if the giving of such rights is required for the purpose of the sale of the goods to end consumers and is regarded by the consumer as a material part of the value of the sold goods."

According to these rules, a franchise agreement and an agreement for a principal franchisee are discharged from the need to obtain an approval of the Anti-Trust Court if they meet the requirements set within these rules.

The aim of these rules is to enable the parties to reach franchise agreements in which one party, the franchisor, limits its right to grant another franchise within the area of the agreement or within a part thereof, or from competing with a franchisee, and the undertakings of the franchisee to refrain from any activity concerning the goods under the agreements towards others^[3].

Such limitations and restrictions are in principle, prohibited by the Anti-Trust law as they are contrary to the object of the law to encourage business competition in the market. Such agreements in which both parties undertake obligations which restrict their future business activities, by definition include limitation of the ability of competition, hence in the absence of these rules, such agreements would have been considered as a violation of the Anti-Trust law provisions and as such would have been regarded as illegal and non-binding.

It should be noted that in the view of the fact that a restrictive arrangement is illegal, the court may raise the issue whether a specific agreement dealt by it is a restrictive agreement, and as such - illegal and unenforceable upon the initiative of the court.

The enactment of these rules reflects the consideration of the Israeli law of franchise agreements to be a necessary tool for the Israeli economy to take share in the global industry and marketing market and regarding such agreements as legal and worth to be protected.

However, according to amendments added to the rules in 2004 and 2006, the exemption granted by the rules will not apply to a franchise agreement concerning which one or more of the following exist:

"3. (1) Where the parties to the agreement are actually competitors or where the franchisor limits the franchisee from using the know how after the end of the contract period even if the know how was exposed to the public or where it may be obtained by a reasonable effort outside the business of the franchisor, or where party to the agreement has a monopoly in the market of the product or in the market of a similar product or where the share of the franchisor in the products market is beyond 30%".

Within this framework of Contracts Law and the Anti Trust Law, the courts in Israel have dealt with various aspects of franchise agreements - such as the right to rescind a franchise, remedies upon termination thereof, the nature of the right transferred to the franchisee whether proprietary or obligatory right etc.

Since the legal system in Israel is principally a common-law system, the court judgments have persuasive force, and the judgments handed down by the Supreme Court are binding on all lower instances (Magistrates and District Courts).

B. Court Judgments and Decisions

B.1 Termination of Contract

In **C.A. 5925/06 Bloom v. Anglo Saxon Agency (26 September 2006)** a company engaged in a real estate agencies network gave a franchise to the plaintiff to run an agency of real estate under its brand name using its services. When Anglo Saxon sent the plaintiff a notice of recession of the contract, he approached the Court for a declaration that there was no right to rescind the contract. The Court dealt with the question: Under which conditions may a franchisor cancel an agreement with a franchisee?

Bloom was granted the right to use the company's logos and services in-exchange for a monthly franchise fee and certain percentages of the revenue. The agreement allowed the franchisee (Bloom) to terminate the contract at any time, under the condition that he will provide the franchisor with a sixty day notice. The agreement does not provide the franchisor the same right but lists a series of conditions under which the franchisor may terminate the agreement. Some of these conditions include events where the franchisee jeopardizes the company's name or trade mark, fails to comply with the payment terms or closes down the business for over thirty consecutive days. During 2002 Anglo Saxon warned Bloom that he is neglecting the franchise and failing to meet their demands. In 2003, Anglo Saxon sent Bloom a six months notice regarding the termination of the franchising agreement. Bloom contended that according to the franchise contract, Anglo Saxon had no right to terminate the agreement and that only due to certain events, may the franchiser revoke the franchise.

The Israeli court ruled that:

1. The relationship between a franchisor and a franchisee is one that is based on mutual trust. When the franchisee does not adhere to the agreement's conditions, this constitutes a justification for the termination of the agreement.
2. When the agreement does not include a specific date for its termination the franchisor may notify the franchisee regarding termination within a "**reasonable amount of time**".

Also in **OM 748/01 Seculife Israel Ltd. vs. Secutech Ltd (17th July 2001)**, the court dealt with the issue of franchise termination agreement without just cause or a violation of the contract's terms.

Seculife produces alarms systems and provides emergencies call center services for subscribers. In 1991 Secutech signed a franchising contract with Seculife for an initial period of five years after which the franchisee has an option to extend the agreement by one year at a time. Secutech may terminate the agreement with a ninety day notice. In 2000 Seculife informed Secutech that they wish to end the franchise contract in 2001 and Seculife filed a motion to the Israeli court asking for a declaration that after 2001, the franchising agreement is void.

The Israeli District Court concluded that because the agreement's draft allowed both sides to terminate the agreement and the final version only granted the franchisee that right, therefore, the franchisor needs just cause to end the agreement with the franchisee. Such reason may include a breach of the contract or specific circumstances, which under the general law of contract justify termination.

B.2 The Nature of the Franchise Right

Another question which was brought before the Israeli court concerned the nature of the relationship between the parties to the franchise agreement: Does the franchise constitute an

agency relationship? Can a franchisor be held liable for law infringements committed by the franchisee (vicarious liability)?

C.A. 2313/03 Guy Ovadia vs. Anglo Saxon and Others (31 July 2007)

The plaintiffs lived in Australia and wished to sell a property in Israel. They contacted the Anglo-Saxon real-estate brokerage agency in Hadera, and their request was handled by Rachel. Rachel was a franchisee of Anglo-Saxon that was granted the right to use the company's name and services in that region. The plaintiffs requested two hundred and forty thousand U.S. Dollars (hereinafter: **USD**) for their property but the agent did not even post "for sale" signs on the property. After five months, a buyer for the price of one hundred and sixty five USD was found, and the deal was finalized. When the plaintiffs later learned that the sole buyer was a son in-law of the agent, they filled a claim against Rachel (the agent) and Anglo-Saxon for damages caused by deceit.

The Magistrates Court ruled that:

1. The agent violated the provisions of the **Agency Law - 1965** by not disclosing the true identity of the buyer and by selling the asset below its market value.
2. **The franchise agreement did not constitute an agency relationship and the franchisor should not be held liable for the franchisee's actions.** The franchise agreement **specifically stated** that the **franchisee is liable for any damages** caused by him or his agents. Furthermore, the nature of the relationship between the parties was such that the franchisor was not informed about the details of any of the deals but rather given a general summary at the end of each month. Under these circumstances, the franchisor could not have known about the existence of the deal and therefore could not be liable for the wrong.

In view of the rapid development of Franchise Agreements in Israel, various issues have not yet been determined by the Supreme Court, especially the issue of the legal nature of the franchise right - whether proprietary or obligatory right; How branding and franchise affect senior businesses' ability to compete with contemporary branded markets; How Property legislation and ruling might be affected by the system of granting Property rights and Contractual rights within the scope of franchise and how will the traditional businesses compete with the new contemporary branded businesses. Time will tell us how. While these questions are indeed important, this article shall not cope with them, however they are worth mentioning, when discussing the franchise phenomenon.

At the same time, the practice and the market's demands have contributed to the formation of some standards and paralegal norms for the Israeli franchise business.

C. Franchising in Israel - The Practice

Actually, until recently, the legal situation in Israel in respect of Franchising, compelled franchisors and franchisees to reinvent their entire relationships with each agreement, in the absence of direct legislation applying thereto. As a result, the franchising system in Israel uses a variety of terminology and provisions.

During the past 5 years, as Franchising in Israel has been developing nation wide quite rapidly, it became clear that a Franchise system should be established in a manner that would give the necessary definitions to Israel's franchise business community. Thus the Israel Franchise Promotion Center (IFPC) was established, and is currently the only public institution in Israel that promotes franchising nationwide and offers assistance to potential and current franchisees and franchisors. The IFPC, a non-profit organization (NPO), was set up jointly by the Israel Small and Medium Enterprises Authority and MATI - the Jerusalem Business Development Center.

In addition to its function as an authority encouraging the business community in Israel to intensify the use of franchising as an efficient means of business expansion, by using multi functioning units, IFPC has set its prime goal to adhere to form a unanimous Franchise Code of Ethics (hereinafter: "the Ethical Code"). Leading franchisors have volunteered to adhere to the high standards provided by the Ethical Code and have agreed to conduct themselves according to this Code and Franchisee Shield.^[4] The Ethical Code has been published and distributed to all Franchise businesses which are registered as such at the IFPC chambers in Jerusalem and can also be seen on the IFPC website, along with the list of the leading franchise chains signed on the Code of Ethics.^[5]

C.1. Franchisee Shield - Disclosure in Franchise Transactions

The franchise relationship creates unique risks for the parties. Some of the most dominant ones are the following:

Franchising exposes franchisees to the potential encounter with unprofessional franchisors. In some cases maybe even franchisors with mal-intentions, under which these franchisees might suffer severe losses, not only financial.

Due to the franchisee's lack of experience, it runs the potential risk of being "blinded" by the Franchisor's offer, without having been properly disclosed with relevant information.

A Franchise system exposes Franchisors to the potential risk of harm to their reputation or to their Intellectual Property due to malfunction of their franchisees.

The above risks draw a somewhat different picture of the franchising system. Though Franchising may seem as a risk free business for investors, disclosure of relevant information is essential for enabling investors to make informed decisions about franchise offerings. Such disclosure also minimizes the risk of both fraud and divergent expectations concerning the franchise relationship. However, despite the above, one should be aware that the compliance costs associated with excessive disclosure regulations can create barriers to entry by new and small franchising companies, generally the greatest source of marketplace innovation.

Section two of the Ethical Code provides as follows:

*"**Proper Disclosure Document Set for Franchisees:** Before initiating any business engagement between a franchising chain and franchisees in the State of Israel, several issues should be clarified and vital information provided concerning the relationship between them. The following documents, included in the Proper Disclosure Document Set (hereinafter: "PDD Set") for Franchisees, will be formulated in a uniform and mutually acceptable format, in simple language, without legal terminology"^[6].*

PDD Set provides the potential franchisee with a tool for exploring what should be the ideal scope of disclosure to arrive at an educated decision, offering a "Franchisee Shield", thereby enabling the franchisee to study what are the relevant questions, and not only the relevant answers.

The Ethical Code demands Franchisors to grant potential Franchisees enough time to explore the disclosed information:

"for at least seven business days from the date that designated franchisees receive the PDD Set, the Chain will not have them sign contracts, make any oral agreements with them or collect payment from them for the franchise. This time period will allow franchisees to study the material, consult with professionals and assess the significance of the proposed transaction".[7]

For potential Israeli Franchisees wishing to penetrate the US market one should note the Franchise rule approved by the Federal Trade Commission (FTC) which was amended to a final version which will be mandatory on 1 July 2008[8].

As a comparison, The European Franchise Federation had regulated the European Code of Ethics for Franchising (hereinafter: **ECEF**), trying to deal with the above mentioned risks in franchising. The ECEF also relates to the pre-contractual phase and creates a Franchisee shield by the requirement of written information concerning expenses, considerations, entry fees, termination clause etc.[9]

C.2 Obligations Taken by the Parties According to the Code of Ethics

Obligations which are set upon the franchisee

- The Franchisee will maximize efforts to develop the franchise branch and maintain the image, identity and reputation of the entire franchising system.
- The Franchisee undertakes to supply the Franchisor with all information concerning branch operation, enabling evaluation of the quality of business management, as well as the financial reports required for effective management of the Chain. The Franchisee will allow the Franchisor and/or its Representatives free access to the franchised business premises and permit examination of the relevant documents.
- The Franchisee undertakes not to transfer any information provided by the Franchisor and any information or "know how" obtained that directly and/or indirectly concerns the Chain, its management and operation to any third party whatsoever throughout the franchising period and thereafter.

Obligations which are set upon the franchisor

The franchisor, on its part, usually takes upon itself these common obligations[10]:

- Franchise permission to use the IP.
- Advertising and marketing of IP

Prolonged escort of the franchisee in various franchise systems, such as: merchandise supply from central warehouses; business guidance; general guidance; and sometimes even financial guidance.

D. Typical Characteristics of a Franchise Agreement in Israel

The franchise agreement may be concluded with an Israeli franchisor or with a foreign franchise chain. As above mentioned, in the absence of a direct definition of a franchising agreement we may compare this legal arrangement with other types of existing agreements. One may compare the characteristics of franchise and agency agreements by reviewing the nature of the rights granted by the various agreements. Generally, one might say that there is a variety of agreements starting from brokerage, agreement for authorized agency, agreement for sub-

agency, distributorship agreement, exclusive distributorship agreement and franchise. The franchise agreement may be regarded as a specific type however as will hereinafter be detailed, it differs from the other agreements by the following accumulating characteristics:

1. **The type of the right granted by the agreement.** The temporary granting of a right to use the brand, the trademark name, etc. i.e. the permission to use intellectual property of others.
2. **The extent of directing and instructing the franchisee.** Instructing, training and accompanying the franchisee during all stages of the management of the business concerning the franchise including teaching work systems, training staff, employees, management systems, clientele list, branding etc.
3. **The extent of the involvement of the franchisor in the daily business.** Involvement and control over the management of the daily business of the franchisee including setting prices and control over the quality of the goods. This may include a requirement from the franchisee to use only specific auxiliary products and also price list uniform to all franchisees in the chain.

The extent of the involvement of the franchisor in the daily business management of the franchisee is an issue which the Israeli regulator tried to cope with.

In 2001 The Anti-Trust Authority published **an order relating to car importers (hereinafter: Car Importers)[11]**. In that case, the local car importers forced the authorized mechanics to use only original spare parts of the foreign manufacturers and by that restricted the ability of the authorized mechanics to compete with other garages.

In addition, pursuant to a demand from the cars manufacturers, the car importers obliged the car owners to maintain their cars only by the authorized mechanics as a condition for obtaining the manufacturer's guarantee for the car, although it concerned also regular maintenance which is not connected to the guarantee.

The authorized mechanics approached the Anti-Trust Commissioner alleging that this is a restrictive arrangement. The car importers on their part argued that the nature of the relationship between them and the manufacturers is of a franchise in view of the level of involvement and the granting of the right to use trademarks and hence they are exempt from the Anti-Trust law provisions.

Finally the parties reached an agreement for the issuance of an agreed order according to which any car owner may decide where he wishes to maintain his car also during the guarantee period, and as regards the authorized mechanics, they will be able to use not only original spare parts but any spare parts which will be approved by the importers as being of good quality.

In view of the fact that this dispute was resolved by an agreement, there is no formal determination whether the agreement between the foreign manufacturer and the local car importers is in fact a franchise agreement. Of course if the determination was positive, the agreement would have enjoyed the exemption from the law, which would have enabled the car importers to apply the contractual term which they imposed on the mechanics.

In the Supreme Court of Labor in Jerusalem[12] this question of involvement was checked by the Court after a claim for severance fee was filed by a lady who managed a clothing store of a fashion company. The Court emphasized that the relationship between the parties was franchise due to the fact that the goodwill of the fashion company and its reputation were given to the plaintiff for the sales of its shop, and the control of the fashion company was not the regular control of an employer but rather a more stringent control which is aimed at safeguarding the reputation of the fashion company which was granted to the use of the plaintiff.

E. The Customary Franchise Engagement in Israel - Master Agreement

Israeli franchisors manage the preliminary engagement in a form of a master agreement issued to the potential franchisee, at which point the IFPC offers potential franchisees to use the franchisee shield[13], in order to be disclosed with the adequate information required to efficiently negotiate the terms of the franchise agreement.[14]

Should the negotiations lead to an agreement, an Annex shall be attached to the master agreement, with the relevant arrangements which had been concluded by the parties. Most franchise agreements involving large corporations as franchisors have the same characteristics. Generally, these agreements are master agreements, with special annexes relevant to each and every franchisee in particular.

Israeli franchisors are deeply involved in the course of the "day to day" business of their franchisees. For example: Israeli franchisors generally insist that the chain shall be the only one in charge of products' pricing, thereby preventing any "inter-brand" competition. Consequently, the franchisees are imposed to find different, more creative ways to make their businesses more profitable. For comparison, European agreements usually allow "inter-brand" competition, by merely setting a maximum price for products, creating the local franchise market to be one of more leverage for marketing and profitability.

E.1. Non Competition Clause. Frequently, the franchisor would seek to impose on the franchisee an undertaking restricting latter's ability to engage in a similar business after the termination of the franchise. Such restrictive undertakings which were included in employment contracts were dealt with by the Israeli courts which determined that they are contrary to the basic right of every person for freedom of occupation, and therefore gave no effect to the non competition restriction, or limited and narrowed its scope in terms of time and geographical areas. Where the restriction was included in a commercial agreement between two companies dissolving their business or partnership, the court regarded it as a "restrictive arrangement" as defined by the Anti Trust Law, and hence illegal and unenforceable.[15]

However, as previously noted, in principal the non competition clause in a franchise agreement will not be voided as being contrary to the Anti Trust Law, nevertheless its limitation should, anyway, be reasonable and proportionate and especially where the franchise was cancelled due to fundamental breach by the franchisee - it will be given effect and enforced.

E.2. Duration of Contract. According to the Israeli Contracts Law (General Part) 1973, a contract which does not include a provision relating to its duration - maybe terminated by the parties with a notice given reasonable time prior to termination. The length of the period which will be considered reasonable - should be checked according to the relevant circumstances - the period of time during which the contract was enforced, the extent of the investments made by the parties, etc.

In the matter of **Eli Bloom v' Anglo Saxon Israel** (hereinafter: "**the Matter of AS**") [16], the Tel Aviv Magistrate Court, presided over by the honorable Mrs. Ruth Ronen, ruled that the franchise agreement does not grant proprietary rights of any kind [17].

This Court ruling ended the affair that had been initiated by the franchisor (Anglo Saxon, one of the largest real estate brokers' chains in Israel, managed by franchising), which had decided to terminate the franchise agreement with one of its franchisees (Mr. Blum), who had not operated to the franchisor's satisfaction. This Court ruling is not foreign to Israeli Courts which are usually very careful about granting property rights pursuant to a franchise agreement.

Most of the old Israeli franchise agreements do not include a termination date for the agreements. This fact, in addition to the court ruling in the Matter of AS, makes franchisees today more alerted to clarify the exact duration of the agreement. Franchisors on their part, of course, deal with this alertness by setting a long set of conditions for prolonging the agreement, thus imposing on the franchisee more obligations.

E.3. Obligations and restrictions set upon the Israeli franchisee. The franchise agreement regulates the franchisee's rights to use the Franchising Brand (hereinafter: **the Brand**), which is subject to complete compliance with the franchisee's obligations to the franchisor. The franchisor owns the Brand and all of the rights subsequent to this ownership [18]. This model opens the agreement to the enforcement of intellectual proprietary laws, thus the agreement shall be governed not only by contract law, but also by Intellectual Property law (hereinafter: **IP**). Observing the franchisor's IP and regulating royalties obliged in favor of franchisor as the owner of the IP are fundamental for creating a solid franchise agreement.

Following are the customary obligations imposed on the Israeli franchisee within the agreement:

1. **Preserving the franchisor's "goodwill", reputation and strength of the Brand.** An Israeli Franchisor would generally ask to ensure that the owned IP and generated reputation therein shall not be offended by a malfunction of the franchisee. "Know-How", "Good Name" and "Reputation" are probably several of the hardest IP rights to lawfully protect.

As reviewed above, in the matter of **AS[19]**, the Israeli District Court in Tel Aviv had been requested to deal with the matter, in the interesting aspect of whether the franchise agreement grants any kind of Property Right.

Judge Ronen ruled (25 May, 2006) that even if the franchise agreement had not contained period provisions, and though years had elapsed (thirty years), based on this fact only, one does not obtain property rights.

2. **Restrictive arrangements.** As mentioned above, the Anti Trust Law exempts certain restrictive arrangements set between parties to a franchise agreement from the applicability of the Anti Trust Law. Thus, it is imperative to not only headline the franchise agreement as such, but also to indeed characterize it accordingly[20]. Consequently, the franchisor should put to use the exemption granted by the Israeli law and regulations, and imposed the franchisee with certain restrictions in order to preserve the franchisor's IP rights, knowledge and information shared with the franchisee for manifesting the franchise most profitably and successfully.

The Constitutional legislation in Israel (also called "Basic Laws") protects one's freedom of occupation and prohibits from imposing limitations on that freedom. On the other hand, franchisors wish to restrict former franchisees from working in similar fields of practice or providing similar services or goods for a certain period after the termination of the contract. In these situations, and as described earlier, the anti-trust legislation in Israel provides certain exemptions when dealing with the franchising mechanism.

In the case of **Tivol (1993) Ltd v. Chef Hayam 1994 Ltd[21]** a non-competition clause was included in an agreement to end a joint venture. After the non-competition clause was violated by one of the parties, the latter was sued for breach of contract. The court determined that the agreement included a forbidden restrictive arrangement and therefore the non-competition clause cannot be enforced. The Israeli court acknowledged that the Israeli Anti-Trust Law contains relatively wide prohibitions regarding restrictive arrangements (as opposed to American legislation for instance, see page 102-103 of the judgment) but it also includes internal mechanisms that allow for certain non-competition agreements, one such case is the franchising structure. We may assume that if the termination of the joint venture between the parties would have been done using a franchise structure, the court may have enforced the non-competition clause.

In the matter of the car importers[22], the agreement was not a franchise agreement, thus the restrictive arrangement had not been enforced.

3. **Marketing and advertising obligations.** An Israeli franchisee would probably seek to be granted with certain exemptions regarding marketing campaigns in which all of the franchisees are demanded to undertake participation world wide. The exemptions that the Israeli franchisee may require are related to the fact that Israel is a country of unique blend of society, and as such. Foreign franchisors are expected to accept that some campaigns, when fully displayed, might affect certain minorities. Experienced franchisees in Israel demand, and usually receive advertising benefits with respect to the level of control on behalf of a Franchisor, especially in the event the Franchisor is a foreign entity.

4. **Evicting the franchisee in case of a fundamental breach.** Some franchises involve managing a business in a shop or a store (hereinafter: **the Premises**). A good example for this kind of business may be a coffee shop or a restaurant managed and owned by a franchisee. In Israel, most franchisees engage in two separate contracts in order to operate the franchise. The first is the franchise agreement with the franchisor, and the second is a lease agreement, made with the owner of the Premises. During the course of business, the franchisee profits from the clientele which attends the premises, usually for food and drinks. This situation would potentially make one of the most complicated issues for the franchisor to resolve, in case of a fundamental breach on the franchisee's part, which may entitle the franchisor to terminate the contract - how will such termination be reflected also as regards the base agreement thus enabling the franchisor to replace the former franchisee with a new one in the same premises..

For example, a franchised coffee shop has signed a separate lease agreement with the owner of the Premises. During the above period of time, the franchisee has formed a certain clientele, some on occurrences, and some regular.

Upon termination of the franchisee, the franchisor wishes to protect its IP rights, within the same geographic territory, and the clientele which attends the premises as a part of the franchisor's IP.

In most cases, the franchisor is not the owner of the Premises. Nevertheless, the franchisor wants to be in control of choosing the Premises, and the manner in which the franchisee conducts its business within the Premises. One of the main problems with the fact that the franchisee is the one who hires the Premises in its name from a separate owner, is that the franchisor has no right to evict the franchisee, as it has no right of possession of the premises. This creates the need to include in the contract provisions so as to bypassing this obstacle within the terms of the franchise agreement.

Is the clientele attending the Premises a part of the franchisor's IP?

In **Motion 1213/04 Mercier Michel and others Vs. Israeli Erez**, the court dealt with the this question.

Mr. Mercier was the franchisor of a hair design parlors network, and Mr. Erez was one of this network's franchisees. In this case, after the franchise agreement had terminated, Mr. Erez moved elsewhere and opened his own hair design parlor. Mr. Mercier argued that the clientele lists in possession of Mr. Erez are the Property of the Brand, as being outcome of the franchise business activity. Mr. Mercier also urged the court to issue an injunction against Mr. Erez from operating his new business, since the clientele which attends the place of business is also Profit which had been gained during the time of the franchise.

The District Court concluded that the clientele lists and the practical clientele which attends the premises are the property of Mr. Erez, being the owner of the business and that the only contribution made by the Franchisors to the franchisee's business, was merely the brand name and their reputation. The court went a step further concluding that despite the fact that one of the franchisee's obligations under the franchise agreement was indeed to return the clientele lists to the franchisor, when the agreement reaches its termination point - this obligation is obligatory in its nature, and does not automatically grant proprietary rights to the franchisor concerning the said lists nor does it forbid the franchisee from using it in the future.

To sum up, in Israel the best method to ensure the control of the franchisor over the property is to rent/lease the property by himself. If it is not possible, the next best choice is to include in the contract financial sanctions that would deter the franchisee from remain in the property after the termination of the agreement.

Conclusion

Though more than twenty five of Israel's largest franchise chains are already signed on the Code of Ethics, and as no direct legislation applies to franchising in Israel, the specific contract between the parties should take care of the issues required for protecting the intellectual property of the franchisor on the one hand, and the business interests of the franchisee on the other hand. It is important to emphasize that the Israeli Chamber of Commerce, and other Commerce authorities, as well as Israeli legislators are mindful of this developing market, and currently are taking steps towards regulating some rules to make Israel a safe business environment for franchising to grow in. The issues open for resolution are:

- Forming a binding and enforceable disclosure format (hereinafter: the Format), with a governing body; one that will have authority to interpret the format guidelines.
- The depth of Due Diligence, required to take place on behalf of the parties.
- Determination on the nature of the rights of the franchise.

These questions and a lot more shall probably continue to occupy franchise figures in the Israel business arena. It is clear that the franchising system in Israel is rapidly taking its course, and so far had successfully proved itself to serve as a wonderful growing tool, in the "Micro" perspective: for Israeli businesses, and in the "Macro" perspective: for Israeli economy.

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- [1] Peretz Sapir, **Franchising: The Fast Track to Money or a Gamble, Israel Globes Magazine**, 16-17 May 2005.
- [2] In 31 July, 2001, The American Senate had approved the Enforcement of the Federal Franchise Rule regulated by the Federal Trade Commission (FTC), which regulate franchisors' proposals to potential investors/franchisees.
- [3] See below for example, the matter of the order relating to car importers published by the Anti-Trust Commissioner.
- [4] See below
- [5] IFPC website, at <http://www.franchise.org.il/Eng/Index.asp?CategoryID=82>, Entry 20 September, 2007.
- [6] <http://www.franchise.org.il/Eng/Index.asp?ArticleID=84&CategoryID=82&Page=1>, Entry 21 October 2007.
- [7] IFPC website, at <http://www.franchise.org.il/Eng/Index.asp?ArticleID=84&CategoryID=82&Page=1>, Entry 18 September 2007.
- [8] <http://www.ftc.gov/opa/2007/01/franchiserule.shtm>, entry 18 October, 2007.
- [9] <http://www.eff-franchise.com/EFF%20Code%20of%20Ethics%20for%20Franchising.pdf>, Entry 21 October, 2007.
- [10] Ofer Friedman, **Managing Business Using Franchise System, Israel Globes Magazine**, Tel Aviv 1988, Page 109-110.
- [11] <http://www.etype.co.il/anti1/?cmd=4&text=1492>, Entry 18 September 2007.
- [12] Labor Appeal 156/99 **Rachel Shreiber (A. Be'eri) Vs. Topper Fashion Factories (1997) Ltd and Others** (Y. Harpaz-Gurevitz), www.psakdin.co.il
- [13] See above
- [14] See page 3-4, and IFPC web site, at: <http://www.franchise.org.il/Eng/Index.asp?ArticleID=84&CategoryID=82&Page=1>, entry date: 14 October, 2007.
- [15] See Section D above.
- [16] Tel Aviv District Court 1356/05, in the matter of **Eli Blum v. Anglo Saxon Property Agency (Israel 1992) Ltd**, <http://www.nfc.co.il/uploadFiles/242504298686982.htm>, Entry date: 20 September 2007.
- [17] See below for further review in this matter
- [18] For further analysis of Franchise Agreement characteristics, see: Ofer Friedman, **Managing Business Using Franchise System, Israel Globes Magazine**, Tel Aviv 1988, Page 100-110.
- [19] See above.
- [20] See Section D above.
- [21] CFH 4465/98 **Tivol (1993) Ltd v. Chef Hayam 1994 Ltd**, PDI 56(1) 56.
- [22] See above.