

# **The Protection of Franchisees in Ethiopia: *De Lege***

## ***Lata and De Lege Ferenda***

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## **Abstract**

*Business format franchise, which emerged in the United States, has become a common way of doing business and subject to regulation in many parts of the world including more recently Ethiopia. Despite the recent legislative developments, the regulation of franchise in Ethiopia is far from being adequate, in particular it fails to provide a clear regulatory framework and is unable to respond to the existing franchise abuses in Ethiopia. These defects result in lots of uncertainties that will inevitably negatively affect entrepreneurship and the emergence of a viable strong local franchise industry as well as be an obstacle in attracting foreign franchisors which could contribute to the country's economy.*

*The aim of this thesis is to critically assess the protection of franchisees in Ethiopia as one of the cornerstones of modern business format franchise by analyzing the recent Ethiopian legislative developments aimed at promoting the business model in light of global and local trends as well as the experiences of selected jurisdictions. The comparison will extend to three countries' laws and experiences. The United States is chosen because of its rich experience in franchise regulation as it is the origin of the business model itself. Hungary was chosen because it represents the other spectrum of the regulation with more historical similarity with Ethiopia and economic proximity in comparison with other European countries and additionally because of similarity in the regulation and protection of franchisees. South Africa has been selected to see the regulation and protection of franchisees because it represents a unique approach to franchise regulation and to see the regulation of franchise from an African perspective.*

## **Introduction**

### **i) The need to assess the protection of franchisees in Ethiopia**

Though the business format franchise originated in the United States, it has become a common way of doing business in many parts of the world. The business model is also subject to a different form of regulation in various countries. The regulation models followed in different countries are different from one another in the mode of regulation which ranges from statutory regulations to industrial self-regulation.

Even though much is not known about business format franchise during the past times, the use of the business format franchise is gaining approval among the business people in Ethiopia and is becoming a common way of doing business, it is also attracting the attention of the legislators. The glimpse of government keenness to regulate the business format can be seen from the new Commercial Registration and Business Licensing Proclamation<sup>1</sup>, Commercial Registration and Licensing Council of Ministers Regulation No. 392/2016<sup>2</sup> which mentions franchise for the first time in Ethiopian legislative history and includes a few provisions regarding franchise. Despite these legislative developments, the regulation of franchise remains filled with gaps, especially as it fails to provide protections for franchisees.

As I will discuss further in the subsequent sections, the main purpose of franchise regulation is responding to practical problems that have been created in the franchising activities due to information and power asymmetry between the franchisee and the franchisor. In order to address this problem, countries use various kind of franchise rules i.e. disclosure-, registration-, and relationship rules which mainly target the protection of franchisees, the weaker party in the

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<sup>1</sup> Commercial Registration and Business Licensing Proclamation No. 980/2016.

<sup>2</sup> Commercial Registration and Licensing Council of Ministers Regulation No. 392/2016.

arrangement. But the new laws promulgated by Ethiopia do not include a single provision aimed at protecting franchisees. The purpose of this thesis is to analyze this legislative gap and propound a feasible legislative solution. Consequently, the central research question of the thesis is how can Ethiopia protect franchisees in order to make it a comprehensive legislative framework that could lead to greater certainty for the effective functioning of a franchise business?

## **ii) On the Jurisdictions within the Purview**

As a comparative study, the protection of franchisees in three jurisdictions, namely the US, Hungary, and South Africa, have been employed herein. The regulation of franchise in each jurisdiction in relation to protecting franchisees will be discussed separately in order to explore the tools developed in each jurisdiction to protect franchisees. The US is selected because of its rich experience in the regulation of franchise and rich literature on the subject area of discussion which is mainly due to the fact that the US is the birthplace of the business format franchise. But it should be noted that this does not necessarily mean the US has an effective regulation of business format franchise. As the regulation is different in the two sides of the Atlantic, Hungary, which has nominated franchise in its new 2013 Civil Code, has been selected as it depicts the other form of regulation distinct from the US. In relative terms, the Hungarian economy is closer to Ethiopia economy than many other European countries and both countries share a common history for being a socialist State. South Africa was selected from other African countries not only because it has the most developed and tested system in Africa but also it has a unique franchise system that traced back to history.

Even though the protection of franchisees does not lie only on the franchise-related legislative framework and it is important to look at the quality of other laws and the broader system of law and justice that could impact the protection of franchisees, the discussion on the regulation and

protection of franchisees in jurisdictions other than Ethiopia does not include a discussion on the broader legislative and justice system because of the limited space allocated for the thesis. A broader discussion on the general legislative framework that could impact the regulation of franchise will be made with regard to Ethiopia as it is a central topic of the thesis.

### **iii) Methodology**

In order to meet the aim of the thesis a doctrinal research methodology has been employed. The primary sources of law including legislations, court decisions, and secondary sources including books, articles, journals, and magazines have been used in developing this thesis. In terms of resources, the United States and South Africa have better accessible materials which could also be associated with the absence of language barrier accessing materials in these two jurisdictions. With regard to Hungary even though it is possible to find materials in relation to the franchise regulation it is limited compared to two jurisdictions.

The strong challenge in preparing this thesis was the dearth of literature on the regulation of franchise and protection of franchisees in Ethiopia where franchise is relatively a new issue and the industry is underdeveloped. The resources resorted to regarding Ethiopia henceforth inevitably had to be limited to the few pieces of legislation containing provisions on franchise and reports of investigative journalists in more widely circulated newspapers in Ethiopia.

### **iv) Structure and use of terminology**

This thesis paper is divided into two chapters. The first chapter will provide a general background discussion and the second chapter will analyze the protection of franchise in Ethiopia and other jurisdictions and propose a recommendation. In order to provide a working definition and lay down an important conceptual framework for further analysis, the first chapter will begin with the

definition of franchise and continue with a discussion about business format franchise. In the last sections of the first chapter a discussion about the need to protect franchisees and the juggling between the regulation of franchise and protection of franchisees will be made to lay down a broad perspective of the regulation and the protection of franchisees. The second chapter begins with a discussion about franchise business in Ethiopia and provides a thorough assessment of the protection of franchisees in Ethiopia franchise regulation. In the next part of the second chapter I will discuss the protection of franchisees in three jurisdictions including the most developed legal system the US., Hungary, and South Africa. Finally, a recommendation will be provided on how should Ethiopia design its franchise legislative framework to protect franchisees.

In this thesis the term 'regulation' refers to every kind of rules and procedures either created by a legislative body, court, or administrative agencies. It is only in two other contexts it refers does refer to the broader meaning of the term and reflects its narrower meaning. The first is when referring a specific piece of legislation in the hierarchy of Ethiopian laws called regulation in which specific reference has been made to show I am referring to that piece of legislation. The second is when referring to franchise regulatory model in which clear reference to the term model has been used.



## Chapter One: Background

### 1.1 Business format franchise

In the early time's franchise has been associated with praxis in medieval England where the subject granted a legal right to collect taxes from the monarch.<sup>3</sup> However, in the contemporary business environment, franchising refers to a particular method of doing business which has revolutionized the supply and distribution of goods and services in many sectors and has formed the business landscape of most countries.<sup>4</sup> Franchising is a system of marketing and distribution, an independent business person called the franchisee is granted the right to market good and service of another called the franchisor.<sup>5</sup> Business format franchise primarily involves the licensing of the franchisor's trademark to the franchisee in which the franchisee can undertake the sale of goods or provision of services. In addition to licensing business format involves elaborated business strategy, marketing strategy, work plan, manuals, standards, and supervision. Franchising can be used as a commercial mechanism for re-engineering business since it enables the business to unlock the commercial value and potential of intellectual property rights both in international and domestic markets.<sup>6</sup>

Different forms of the franchise have been developed through times, product- and manufacturing franchise could be mentioned as an example. Product franchise which is the relatively the simple and earliest form of the franchise system in which a distributor franchisor supplies products to retailer franchisee which in its turn distributes in the products to users with the understanding that the later will have the exclusive right to sell the products in a particular area of the market, even

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<sup>3</sup> Black's Law Dictionary, (6th ed., WPC 1996).

<sup>4</sup> Elizabeth Crawford Spencer, *the Regulation of Franchising in the New Global Economy* (Edward Elgar, 2010) viii.

<sup>5</sup> Dean T. Fournaris, 'the Inadvertent Employer: Legal and Business Risks of Employment Determinations to Franchise Systems' (2008) 27 FLJ 224.

<sup>6</sup> Abell M., *The Law, and Regulation of Franchising in the EU*. Edward (Elgar 2013).

though the market is not necessarily defined in geographic terms.<sup>7</sup> Clothing business, gas distributions through retail stations and automobile dealerships are among the business areas where product franchise is used frequently. Manufacturing franchising is a method in which the franchisor will give particular specifications or elements that the franchisee uses in producing the product.<sup>8</sup> Soft drink manufacturing is a good example of processing or manufacturing franchise. A business format franchise is a generic term which encompasses the different type of franchise forms and involves the provision of the extensive and comprehensive operating system by the franchisor to the franchisee.<sup>9</sup> The concept is based on the idea of cloning the business identity of a reputable and successful business entity.<sup>10</sup> This has been also noted by Unidroit Guide which stated that business format franchising is increasingly coming to represent the whole franchising.<sup>11</sup>

## **1.2 The need to protect franchisees**

The regulation of franchise in most jurisdictions mainly aims at protecting franchisees which is the result of the asymmetry of power and information which lead to opportunistic behavior and practices. As Professor Tajti states "a closer look at business format franchise reveals that asymmetry is a distinguishing characteristic of franchise contracts and asymmetry is indeed a sine qua non of this."<sup>12</sup> The regulation of franchise in most jurisdictions revolves around curbing this asymmetry and tackling the opportunistic behavior and practices of the franchisor and sometimes the franchisee.

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<sup>7</sup> Francity, 'Types of Franchises', <<https://francity.com/about-franchising/types-of-franchises/>> accessed 11 May 2020.

<sup>8</sup> Elizabeth Crawford Spencer, 'Potential Enhancements for Business Performance through Franchising: The Case of Coffee in Vietnam', (2001) 7 ABL 51, 59.

<sup>9</sup> *ibid.*

<sup>10</sup> Tamara Milenkovic Kerkovic, 'The Main Directions in Comparative Franchising Regulation – Unidroit Initiative and its Influence', (2010) 13 ERS

<sup>11</sup> UNIDROIT Guide to International Master Franchising Arrangements 1998 (rev.2007)

<sup>12</sup> Tibor Tajti, 'Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?' (2016) 37 LLICLR 245, 248.

Investigating the genesis of the need to protect franchisees by interfering into private relationships leads to the fact that the basic premise on which the principles of freedom of contract and sanctity of contract rest does not work for franchise contracts since they are negotiated between unequal parties. This hampers the effective functioning of the fundamental principle of contract, freedom of contract, in a franchise agreement. Hence, this contract between unequal parties in terms of information and power asymmetry requires a legislative intervention that aimed at protecting franchisees which is the main purpose of franchise legislation in many jurisdictions.

The protection of franchisees in Ethiopia is more important than other developed countries since the information and power inequality between Ethiopian franchisee and the foreign franchisor is broader than the one where both parties are from a developed country which has the exposure and the experience about the business operation legal technicalities. As a result, the franchise agreements between a foreign franchisor and Ethiopian franchisee do not come out of negotiation of the parties and the agreements are generally standard form contracts drafted by the franchisor which does not take into consideration the Ethiopian business context. Not surprisingly, the agreements are drafted in the way it protects the franchisor's interests. The Ethiopia franchise law should understand the risk assumed by franchisees particularly by domestic franchisees.

In order to address facilitate informed business decisions and reduce countries have developed four commonly used regulatory tools or rules. These are disclosure rules, registration rules, and related rules. The disclosure rule which was first developed in the US is a rule which requires a franchisor to disclose certain information before concluding the franchise agreement. The relationship rule regulates the relationship between the franchisor and franchisee after the conclusion of the franchise agreement including the manner of ending the relationship and resolving a dispute, whereas, registration law is indented to the administrative procedure which

prescribes obligation of notification or registration of the franchising agreement prior or after its conclusion.

### **1.3 The regulation of franchise and protection of franchisees**

Most of commercial activities and transactions, if not all, are built upon the confidence underpinned by a legal framework and infrastructure on the participants of the market.<sup>13</sup> Besides that parties with the intention of controlling the nature and effect of their commercial activities and transactions privately regulate their relationship at different layers of the market using a contract. As a result, the question raised with regard to regulation of commercial activities including franchising is not whether to regulate rather but how to regulate.<sup>14</sup> That is why we have different regulation mechanisms or franchise regulatory models.

In order to respond to the mechanisms of franchise regulation, California adopted was the first to adopt franchise-specific law, 1971 Franchise Investment Law, which was based on the securities law model and imposed on the franchisor disclosure and registration requirements and then followed by federal disclosure law at the end of the decade.<sup>15</sup> Even though the global community was quick to embrace the US franchise as a business model but they were not enthusiastic about embracing the US regulation model and resulted in different franchise regulatory models.<sup>16</sup> Even though it is not easy to agree on the classification of franchise regulatory models, the franchise regulatory model can be classified into three main regulatory models i.e. the regulatory model, the private law-based models, industry-standards (or self-regulatory) model.

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<sup>13</sup> Elizabeth Crawford Spencer, *the Regulation of Franchising in the New Global Economy* (Edward Elgar, 2010) 5.

<sup>14</sup> Spencer (n 4) 44.

<sup>15</sup> *ibid* 146.

<sup>16</sup> *ibid* ix.

The regulatory model is characterized by the interference of the state into private business relationships and put a limit to freedom of the parties based on chosen policy orientation which is the protection of franchisees in the case of a franchise. The United States, the origin of the modern business franchise, represents the regulation model given that a complex web of federal and State legislation aimed at the prevention of abuses by franchisors. As sector-specific regulations, the task of enforcing mandatory rules is made by specialized governmental agencies and the agencies have been also tasked to act as gatekeepers to regulate who may enter the market based on enabling statutes. It has been stated that this will result in *ex-ante* protections of franchisees and which make the model the best way to protect the franchisees.<sup>17</sup>

The private law-based model is based on the presumption of the existence of franchise-specific rules enshrined in civil (or commercial) codes or statutes of equal status and features. This model is dominant in several Continental European jurisdictions.<sup>18</sup> The regulation of franchise in Ethiopia could also be categorized under the private law mode as the regulation of franchise in Ethiopia administered by the newly promulgated Commercial Registration and Business Licensing Proclamation No. 980/2016, Commercial Registration and Licensing Council of Ministers Regulation No. 392/2016, are commercial registration laws containing franchise rules. In addition, the franchise regulation in Ethiopia is supplemented by the civil and commercial codes. In this model, the protection of franchisees depends on “how embedded the respect for law and contractual commitments in business people is, or what the level of the rule of law is, in a given jurisdiction.”<sup>19</sup> The protection of franchises in jurisdictions in which the level of respect for law and contractual commitment is lower is in jeopardy. The crucial difference between the regulatory

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<sup>17</sup> *ibid* 72

<sup>18</sup> *ibid* 75

<sup>19</sup> *ibid* 72

model and the private model is, unlike the former in the private law model there is no specialized government agency that enforces mandatory provisions and private parties' fate depends on their own hands.

In the industrial self-regulatory model, the main source of franchise law is a “form of industrial self-regulation codes of conduct or codes of ethics drafted and promulgated by the industry itself (i.e., trade associations)”<sup>20</sup> or in other words this occurs when a specific industry body assumes responsibility for prescribing its own rules and conduct.<sup>21</sup> Self-regulation provides a balance between no regulation at all and strict governmental controls as industry codes of conduct are more flexible than regulation by statute and can be easily revised as voluntary standards of conduct.<sup>22</sup>

In reality these distinguishable models rarely exist in isolation and it is not possible to draw a strict line between these models put into one category. That is why some systems follow a mixed approach of all systems. "Some post-socialist and non-European emerging countries have mixed solutions, not infrequently with idiosyncratic elements and tenets."<sup>23</sup>

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<sup>20</sup> Tibor Tajti, *Systemic and Topical Mapping of the Relationship of the Draft Common Frame of Reference and Arbitration* (KZU 2013), 77.

<sup>21</sup> Kerkovic (n 10) 112.

<sup>22</sup> *ibid.*

<sup>23</sup> Tajti (n 20) 80.

## **Chapter Two: The Protection of Franchisees in Ethiopia and Other Selected Jurisdictions**

### **2.1 Franchise Business in Ethiopia**

Even though the details of the agreement or further information are not available, it has been reported that decades have passed since the first franchise business opened in Ethiopia.<sup>24</sup> It was during the imperial era, in 1969, when Hilton Hotel was opened through franchising in the capital city, Addis Ababa.<sup>25</sup> This indicates that Ethiopia had five decades of old history in bringing international franchisors into the country. But the expansion of the system has lagged behind and its contribution to the general economy has been limited among others due to the repressive policy of the socialist regime and a protectionist policy of its successor.<sup>26</sup> Even though the service sector contributes much to the Ethiopian economy, the role of a franchise to the economy is much lesser than it could have be. This is so as most of the international brands in Ethiopia do not work via comprehensive franchise involving the transfer of a full package of knowledge rather limited to licensing of trademarks and tradenames. It is another problem that the current share of franchise system in the service sector has not been documented and it is difficult to talk about its contribution to the economy with certainty.

But in recent years international franchisors in collaboration with domestic franchisees have opened franchise outlets in some parts of the country. Mention should be made, in particular, of Pizza Hut, Hilton Hotel, and Kentucky Fried Chicken (KFC). It has been also reported that several other international franchisors are on the pipeline to open their outlets in Ethiopia in the coming

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<sup>24</sup> Kaleab Girma, 'Hilton Addis Refurbishes Facilities' (Addis Fortune, 4 May 2019) <<https://addisfortune.news/hilton-addis-refurbishes-facilities/>> accessed 20 May 2020.

<sup>25</sup> Ethio-America Investment and Trade Council, 'Hilton Addis Ababa: Heart of a Great City' <<https://www.africa-ata.org/hiltonaddis.htm>> accessed 15 May 2020.

<sup>26</sup> The military and socialist came to power in 1974 in a coup d'état on the imperial regime which ruled Ethiopia between 1916–74. The military regime was overthrown in 1991 by EPRDF and ruled the country until 2018.

years.<sup>27</sup> There is a potential that domestic brands could also engage in the business of franchising.<sup>28</sup> The business has a huge potential of growth and it has legitimately attracted the attention of the Ethiopian legislator as well.

## **2.2 The Protection of Franchisees in Ethiopia**

Until very recently, Ethiopia did not have a law specifically mentioning franchise in any form. It was in 2016 that laws specifically mentioning franchise and regulates franchise agreements were enacted in Ethiopia. These are Commercial Registration and Business Licensing Proclamation No. 980/2016 and its subsidiary regulation, Commercial Registration and Licensing Council of Ministers Regulation No. 392/2016. The Proclamation contains four provisions regarding franchise dealing with a definition of franchise agreement, registration of franchise, and standards of conduct of the franchisee. The subsidiary regulation deals with the necessary documents for the "registration, renewal and cancellation of special certificate of franchising".<sup>29</sup>

The Proclamation defines franchise agreement as an "agreement concluded for consideration between the franchisor and the franchisee in order to undertake business activities by using the trade name of the known product or service in order to share the nature and experience of the work under the leadership of the owner of the products and the service that has got recognition". A closer look at the definition of franchise and franchise agreement in the UNIDROIT Model Franchise Disclosure Law and a discussion about the meaning of franchise in chapter one reveals the three important elements in the definition of franchise. These are controlled by the franchisor, payment of fee, and licensing of intellectual property including trademark, service mark, trade name or

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<sup>27</sup> Addis Fortune, 'Franchise Influx Requires Legislative Demand' <<https://addisfortune.net/columns/franchise-influx-requires-legislative-demand/>> accessed 18 May 2020.

<sup>28</sup> Ethiopian Reporter, <<https://www.ethiopianreporter.com/index.php/article/13785>> accessed on 19 May 2020.

<sup>29</sup> Commercial Registration and Licensing Council of Ministers Regulation.



logotype, and know-how. The definition given by the Proclamation encompasses the three important elements of a franchise agreement, but it has limited the nature of intellectual properties to be licensed only to tradename. This could create ambiguity in what kind of agreements considered as franchise agreements. It would be reasonable to expect that franchisees may face a challenge that the agreement they concluded is not a franchise agreement. As Ethiopia follows the tradition of continental legal systems, courts and other administrative authorities are expected and inclined to use a literal interpretation of laws. Such plain language interpretation makes the aforementioned problem inevitable in practice. One of the issues that have to be addressed in the future legislative amendment is making the definition of the franchise agreement as clear as possible encompassing the necessary element of the definition of the franchise agreement which is missing in the current definition.

The other provisions of Proclamation deal with the registration of franchise and states that "the registration of the franchise shall be conducted pursuant to the provisions of the regulations."<sup>30</sup> The regulation in turn lists the necessary documents for getting, renewing, and substituting a special registration certificate of franchising. Even though the law does not expressly state whether the franchisee or the franchisor should get this 'special certificate' it looks it is a special certificate given to the franchisee since one of the documents that have to be submitted with the application for the certificate is 'trade license' of the franchisee.<sup>31</sup> There is no mandatory provision in the Proclamation and the Regulation or any other law, however, which would require obtaining of the certificate as a precondition for entering into a franchise agreement and engaging in the business of providing services based on that agreement. Further, the law does not state any consequences

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<sup>30</sup> Art 37, Commercial Registration and Business Licensing Proclamation.

<sup>31</sup> Art 48(3), 49(2), 50(2), Commercial Registration and Licensing Council of Ministers Regulation.

for failure to have a special certificate while engaging in the business. Hence, the application for the special certificate and registration requirement is not a mandatory requirement a franchisee or a franchisor should have to engage in the business. But if the franchisee intends to get this special certificate, one of the documents that have to be submitted for the application of the certificate is a “notarized franchising contract”.<sup>32</sup> But it is difficult to consider this as a franchise registration requirement as this is a mandatory obligation. As we can see from the experience of other countries which will be discussed in subsequent sections, the registration requirements are mandatory obligations bestowed on the franchisor aiming at the protecting franchisees before the conclusion of the franchise agreement. The registration requirement under the proclamation does impose a mandatory obligation and does not serve the purpose of protecting franchisees and it is a mere optional requirement that is not common in other jurisdictions.

The other issues the Proclamation deals with are standards of conduct of the franchisee. The law asserts that “the franchisee shall function on the same standard as the franchisor”<sup>33</sup> and “clients shall obtain the same product and service from the franchisee as they would have gotten from the franchisor.”<sup>34</sup> This should have been more of a concern for the franchisor than the legislator as it is in the best interest of the franchisor to control and supervise the goods and services provided by the franchisor. Even though it is found necessary to provide the franchisees with the legal standard of conduct it would more clear if the standard of conduct referred in the law is a standard of performing according to the contract than using the ambiguous term "the same standard as the franchisor" which is difficult to determine as most franchisors direct business engagement is becoming limited. This is due to most franchisors are companies operating several brands with

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<sup>32</sup> Ibid, art 48(1).

<sup>33</sup> Art.37(2), Commercial Registration and Business Licensing Proclamation.

<sup>34</sup> ibid art 37(3).

limited outlets directly owned by them, for example, the two brands in Ethiopia Pizza Hut and KFC are owned by Yum brands which own several other brands.<sup>35</sup> The standard of requirement does add much to the contract but creates ambiguity on the standards of performance expected from the franchisee.

In an unusual way of regulating franchise, the franchise rules introduced by the Commercial Registration and Business Licensing Proclamation No. 980/2016 and its subsidiary regulation, Commercial Registration and Licensing Council of Ministers Regulation No. 392/2016, provides a legislative burden that is only applicable to franchisee. The law does not impose any obligation on the franchisor. This will have the effect of exacerbating the inherent information and power imbalance between the two parties let alone to play a role in safeguarding the interest of franchisees and it creates more problem than it solves if tested in practice.

The other important part of the Ethiopian franchise legislative framework is general contract law. The general contract law provisions contained in the Ethiopian Civil Code provide a general principle of contract law that applies to all kinds of contracts. Franchise agreements are no exception to the rule and general contract law provisions will also govern franchise agreements concluded in Ethiopia unless the parties opt-out for the application of other law.<sup>36</sup> The general contract law provisions cannot also protect the franchisees in the inherently imbalanced franchise relationship because the general contract law provisions are supplementary contracts and parties are free to disregard such general principles by expressly stating everything in their contract. Like any other contract the obligations in franchise agreements are also going to be enforced by the parties themselves in our case by the franchisor and franchisee.

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<sup>35</sup> Yum! Brands, <<https://www.yum.com/wps/portal/yumbrands/Yumbrands/company>> accessed 20 May 2020.

<sup>36</sup> Title Xii of the Ethiopia Civil Code.

The other important rules that enormous impact on the regulation of franchise in Ethiopia are foreign exchange rules. It is important to understand that Ethiopia's foreign exchange rules require the registration of loans and suppliers' credits, which includes franchise agreements if franchise fees and royalties are payment is going to be made from Ethiopia in foreign currencies. It could be said that Ethiopian foreign exchange rule has established registration requirements for franchise agreements and the National Bank of Ethiopia is serving as registering authority of these agreements as far as the parties are planning to process payment from Ethiopia.<sup>37</sup> As one reasonably expect, even though the foreign exchange rules have established franchise registration requirement they don't have the objective and the effect of protecting franchisees rather than regulation foreign exchanges.

In many countries trademark laws are an indispensable element of franchise legislative framework. This is due to the fact that part of the franchise allure is the strength of the franchisor's brand quality represented by its trademark.<sup>38</sup> Hence, trademark protection and trademark registration are one of the most critical aspects of franchise laws.<sup>39</sup> This is also true for Ethiopia. However, the Ethiopian trademark laws have failed to protect franchisees from fake trademark users. A franchisee who has legally entered into a franchise agreement with foreign franchisors and brought to the country foreign brands are facing a challenge from fake trademark users. The fake franchisees in Ethiopia use trademarks, trade names, and logos of foreign brands without a license from foreign owners. They can do that exploiting the legislative gap in the Ethiopian trademark law which does not automatically recognize foreign trademarks. Ethiopia is not a member of the Madrid Agreement and the Madrid Protocol that could result in the automatic recognition of

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<sup>37</sup> *ibid.*

<sup>38</sup> 'Franchise Law Review in the United States', (21 February 2018 The Law Reviews) <<https://thelawreviews.co.uk/chapter/1159256/united-states>> accessed 11 April 2020.

<sup>39</sup> Ethiopian Trade Registration and Protection Proclamation No.501/2006.

international trademarks in Ethiopia. Hence, Ethiopia's trademark law does not protect foreign trademarks unless the trademark is registered in Ethiopia.

One of the victims of this legislative gap was an Ethiopian hotel services franchisee who entered into franchisee agreement with a foreign brand called Crowne Plaza but was forced to look for other franchisors as the name has already been registered and been in use by another local hotel called 'Crown Hotel' which did not have a license to use the trademark from the owner of the trademark. This became a court case that lasted for four years between Six Continents Hotels (which later become InterContinental Hotels Group) vs. Crown Hotel (Ethiopia).<sup>40</sup> The case started when Six Continents Hotels owner of Crowne Plaza brand at the international level filed an application for registration of its trademark in Ethiopia and the Ethiopian Intellectual Property Office rejected the application stating there is a similar trademark registered in Ethiopia by Zewditu Mesfin owner of local Crown Hotel.<sup>41</sup> The two parties took their case to court which went up the Federal Supreme Court Cassation Bench which decided in favor of Zewditu. Then, in a rare case of an application for constitutional interpretation to the House of Federation, Six Continents filed an application which finally reversed the decision and gave a decision which allowed Six Continents to register its trademark in Ethiopia.<sup>42</sup>

In the unfortunate circumstances for franchisee, there are a handful of similar ongoing cases between, Intercontinental Hotel(Ethiopian) Vs InterContinental Hotels' (IHG), IN-N-OUT Ethiopia Vs IN-N-OUT(US).<sup>43</sup> In all of these cases a suit opened by fake franchisors legal

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<sup>40</sup> Capital Ethiopia, 'Crown Plaza Gets Copy of Ruling After 10 Months'(Capital Ethiopia, 30 July 2018) <<https://www.capitalethiopia.com/capital/crown-plaza-gets-copy-ruling-10-months/>> accessed 15 May 2020.

<sup>41</sup>ibid.

<sup>42</sup> Fasika Tadesse, 'House Speaker Ends Trademark Saga' (Addis Fortune, 28 July 2018) <<https://addisfortune.net/articles/house-speaker-ends-trademark-saga/>> accessed 20 May 2020.

<sup>43</sup> Dawit Endeshaw, 'Rising Trademark Debacle' (Ethiopia Reporter 2 September 2017) <<https://www.thereporterethiopia.com/content/rising-trademark-debacle>> accessed 20 May 2020.

franchisees on foreign franchisors and local franchisees was an obstacle for local franchisees to run and operate legally franchise business. This is mainly due lack of protection in Ethiopian franchise and trademark laws. This and similar gaps in the laws will inevitably hinder development of Ethiopian franchise business unless a proper, franchise-friendly legislative solutions shall be introduced.

### **2.3 The Protection of Franchisees in the United States**

According to Franchise Business Economic Outlook 2018 the US hosts the biggest franchise industry in the world.<sup>44</sup> The United States is not only a country with the largest franchise industry but also has the most developed, though quite sophisticated multi-layer franchise law in which general contracts and other classical branches of law play a supplementary role only.<sup>45</sup>

As the US is a federal-State, there is a franchise regulation at both State and federal levels of government. At the federal level, the Federal Trade Commission (FTC) is the regulatory body overseeing the franchise sector and the main rules are incorporated in the Franchise Rule which was originally promulgated in 1978 (as amended in 2007), Disclosure Requirements and Prohibitions Concerning Franchising & Disclosure Requirements Concerning Business Opportunities 16 CFR Parts 436 and 437.<sup>46</sup> Although the role of federal regulation is an indispensable part of US law, the regulation of franchises in the US is mainly a matter of State law and therefore varies from State to State. Consequently, the regulation of franchising will hugely

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<sup>44</sup> International Franchise Association, 'Franchise Business Economic Outlook for 2018' (January 2018) <[https://www.franchise.org/sites/default/files/Franchise\\_Business\\_Outlook\\_Jan\\_2018.pdf](https://www.franchise.org/sites/default/files/Franchise_Business_Outlook_Jan_2018.pdf)> accessed 20 May 2020.

<sup>45</sup> Tajti (n 20) 66.

<sup>46</sup> Federal Disclosure Requirements and Prohibitions Concerning Franchising & Disclosure Requirements Concerning Business Opportunities - 16 CFR Parts 436 and 437.

be influenced by the type of State regulation under consideration i.e. the domicile State of the company and the place of franchise business operation.<sup>47</sup>

The first step in the regulation of franchise in any jurisdiction is defining what franchise means and determining the scope of application of the law which lays down the ground for the protection of franchisees. According to the FTC Rule “franchise means a commercial business relationship whereby the franchisee is granted the right to sell goods and services that are identified and directly related to the franchisor's trademark”.<sup>48</sup> Besides, there are also other criteria that have to be fulfilled to be deemed a franchise i.e. the franchisor should exercise control over the business operations of the franchisee and the franchisee should receive detailed guidelines and assistance.<sup>49</sup> In the States of California, Washington and a few other franchises are defined as an agreement by which the franchisee is granted the right to undertake business operations under a marketing plan prescribed by the franchisor. In both federal and State-level definition, the contribution of franchisee or payment of a fee by the franchisee is taken as an additional element for the definition of franchising.<sup>50</sup>

Even though both the federal and State rules of franchise define franchising, there is no bright-line test which can be uniformly applied with absolute predictability. But defining the term franchise will help in creating measurement criteria whether a particular arrangement is a franchise or not and decide on the scope of application of franchise rules though the fulfillment of criteria is a question of fact. The law by defining the word franchise avoids the ambiguity that could occur on the designation of a particular relationship as a franchise.

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<sup>47</sup> Peter S. Selvin, ‘Local Franchise Regulation and Investment in the US’(1995) 14 IFLR 40 (1995).

<sup>48</sup> FTC Franchise Rule (n 47).

<sup>49</sup> *ibid*, Spencer (n 4). FTC Franchise Rule (n 47).

<sup>50</sup> *Ibid*.

The protection of franchisee in the US franchise regulation begins with the tendency of the courts to liberally construe the definition of the term franchise so as to broaden the scope of definition which is derived from the purpose of State franchise laws, protecting franchisees. The court in *Kim v. Servosnax* case held that the term franchise should be construed broadly in order to incorporate a group of investors protected by the law.<sup>51</sup> In view of this, it should not be surprising that the specific label, name, or title given to a business arrangement will not be decisive. The definition of franchise and the broad interpretation rule is the first tool at the disposal in the US to protect franchisees by determining and broadening the scope of a particular type of investors who considered as franchisees.

As its full name indicates the FTC Franchise Rule, Disclosure Requirements and Prohibitions Concerning Franchising & Disclosure Requirements Concerning Business Opportunities, is a disclosure rule which requires franchisors to disclose material information to prospective franchisees which will give them the opportunity determine and assess the risks and benefits of entering into an agreement of franchising business.<sup>52</sup> Even though the concept has been borrowed from capital markets law, the terms material information means an information a franchisee would consider important in deciding whether to enter into a franchise agreement or it could be described as information that is reasonably certain and has a significant effect on the amount of royalty to be paid to the franchisor.<sup>53</sup> The law requires franchisors to produce a disclosure document that contains 23 specific items of information including the offered franchise, its officers, past and current franchisees, litigation history, any exclusive territory offered, the support available to the

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<sup>51</sup> *Kim v Servosnax Inc*, 10 Cal App 4th 1346, 1356 (1992), <<https://law.justia.com/cases/california/court-of-appeal/4th/10/1346.html>> accessed 18 May 2020.

<sup>52</sup> FTC Franchise Rule (n 47).

<sup>53</sup> *ibid*.



franchisee, and the cost of initial investment for starting the business.<sup>54</sup> As both layers of government have jurisdictional power to regulate franchise, the Federal FTC Rule establishes the minimum standard of disclosure requirements, and states are entitled to adopt a more stringent disclosure law. At the State level, California was the first to adopt franchise sales law which required disclosure back in 1970, and other States including Michigan and New York have also followed the path. Normally, the same disclosure document can be used to satisfy the disclosure obligation under both layers of government.<sup>55</sup> The disclosure of such kind of information will give the opportunity for the franchisee to access information that may not be available had it not been for the disclosure law which aimed at ex-ante protection of franchisee.

As revealed in the first chapter, one of the distinguishing features of the franchise regulatory model represented by the US. is the intervention of the State into private business relationships which aimed at the protection of franchisees. In other words, in the US, the enforcement of disclosure rule is not left to private parties rather the enforcement is bestowed to a dedicated agency at State level, besides the generally available contract and tort law means of enforcement tools.<sup>56</sup> Thus, an obligation arising from the franchise, private relationship, will be enforced by public money. This a distinguishing feature of US franchise regulation and it is a robust mechanism of protecting franchisees.

Even though the Federal Franchise Rule does not require registration filing or approval by any agency, fifteen States bestow franchise registration requirements. In some States like Michigan the registration requirement is a simple procedure of filing a page long notification stating the identity of the franchisor and its designated agent for service of the process before entering into the offer

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<sup>54</sup> *ibid.*

<sup>55</sup> Spencer (n 4) 147.

<sup>56</sup> Tajti (n 20) 66.

and sale of a franchise. On the other hand, in some States like Hawaii and South Dakota the registration requirement is a more burdensome procedure in which the franchisor is required to annually file an application to the state agency and the application will be subjected to administrative review and approval.<sup>57</sup> The agency entrusted with the enforcement of the regulation has been given the right to review and pass judgment on the viability of the franchise system to be offered.<sup>58</sup> In the States where this approach has been adopted the franchisees have been conferred additional layer of security.

The FTC Franchise Rule is a law on disclosure and there is no other federal legislation dealing with franchise relationship aspects of the regulation. But there are states with relationship statutes that go beyond regulating disclosure and regulate other aspects of franchise relationship including termination, dispute resolution, renewal, assignment, encroachment, freedom of association among franchisees, discrimination, and standards of performance of the contract on franchisees.<sup>59</sup> Among these relationship rules the significant tools that can be used for the protection of franchisees are termination and dispute resolution rule.

In relation to regulating the end of the franchisee-franchisor relationship many States including California and New York have adopted franchise relationship laws that provide protection from wrongful termination of the relationship. In respect of dispute resolution rules, the Arbitration Fairness Act of 2009 makes any pre-dispute arbitration agreement invalid or unenforceable that requires the arbitration of a franchise agreement, and many states have also adopted similar laws in their jurisdiction. These protective statutes are enacted in consideration of the perceived asymmetry that exists between the parties and was designed to protect franchisees against

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<sup>57</sup> Spencer (n 4) 148.

<sup>58</sup> Tajti (n 20) 69.

<sup>59</sup> *ibid* 73.

indiscriminate termination.<sup>60</sup> Overall, the US with its comprehensive franchise rules have a robust mechanism of protecting franchisees which ensures ex-ante and ex poste protection of franchisees.

#### **2.4 The Protection of Franchisees in Hungary**

According to the information from Hungarian Franchise Association franchising has become the common mode of doing business in Hungary and approximately a total number of 300-350 franchise networks are operating in Hungary with around 20,000 franchisees and 100,000 employees including those working in supply channels.<sup>61</sup> Regarding the origin of the franchisors the franchisors most came from the Netherlands, Germany, United States, Italy, France, and Belgium. Hungarian franchisors have spread to other countries, Slovakia, Romania, Ukraine, Czech Republic, Poland, Bulgaria, Russia, the United Kingdom, Moldova, Azerbaijan, and Egypt.<sup>62</sup>

With regard to the regulation of franchise in a post-socialist CEE civilian system, Hungary, currently, the regulation of franchise is mainly based on the 2013 Civil Code, which nominated the franchise contract for the very first time in the country's history. But before diving into present-day regulation of franchise in Hungary it is important to mention pre-Civil Code era franchise regulation as it is similar to the situation in Ethiopia and helps to recognize the new development brought by with the Civil Code.

Before 2013 Hungary was a country that has neither a *lex specialis* nor provisions on a franchise in its earlier Civil Code from 1959. The old Civil Code regarding contracts embraced a dual-tiered traditional civil law structure in which the contracts were regulated in the first part, general rules

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<sup>60</sup> Spencer (n 4) 148.

<sup>61</sup> Hungarian Franchise Association, <<http://www.franchise.hu/English/Franchising+in+Hungary>>\_accessed 18 May 2020.

<sup>62</sup> *ibid.*

of contracts, and the second part containing specific types contracts regulation such as sales, lease, and commission.<sup>63</sup> Agreements that have not been mentioned in the second category are not enumerated and specifically regulated by the Civil Code hence they are called ‘atypical contracts’.<sup>64</sup> Franchising as formerly one form of atypical agreement was considered as mixed contracts, due to the fact they contained elements of different specifically mentioned ‘typical’ agreements.<sup>65</sup> The problem here would be the difficulty of finding out which specific contract's regulatory regime is applicable. In the specific regulation during the pre-civil code era of the Hungary franchise regulation, the rules that could be applied to franchising agreements were determined on a case by case basis considering the specific terms of the contract.<sup>66</sup> Franchising could combine elements of different 'typical' agreements and establishing which specific regulation will be determined by referring to which contract types' elements dominate the agreement. This approach had been criticized for being problematic as the applied rules imposing rules which parties haven't agreed to be applied and presented as an approach that could lead to unpredictability.<sup>67</sup>

It was this problem that puts Hungary in a dilemma whether a franchise contract should be nominated as a distinct type of contract. Eventually franchise was recognized as a nominated contract and was enshrined into the 2013 Civil Code. The related paragraphs are short and are default (dispositive) rules. The provisions of the Civil Code regarding franchise starts with providing an indirect definition of franchise contract and then deals with liability with respect to

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<sup>63</sup> Zsófia Oláh and Csongor István Nagy, *Enforcement of Contracts in Hungary*, in Stefan Messmann & Tibor Tajti (eds.), *THE CASE LAW OF CENTRAL AND EASTERN EUROPE – ENFORCEMENT OF CONTRACTS* (European University Press, Bochum-Germany, 2009), at 288.

<sup>64</sup> *ibid.*

<sup>65</sup> *ibid.*

<sup>66</sup> *ibid.*

<sup>67</sup> Tajti (n 20) 69.

licensed intellectual property, the franchisor's supply obligation, the protection of the good reputation of the franchise network, the franchisor's instruction and supervisory rights, and conditions on the termination of contracts made for an indefinite period.<sup>68</sup>

Notwithstanding the fact that franchise as a specific nominated contract was enshrined into the new Civil Code, together with a few provisions on offering and selling of franchises, this paradigm change is weakened by the fact that the provisions are not mandatory but default rules. To put it differently, contractual parties are allowed to opt-out of the general principles by determining their own terms, without paying deference to rules in the Civil Code, but it serves as a general point of proper orientation for any person who intends to conclude franchise agreement.<sup>69</sup> This will leave franchisees without mandatory franchise rules which will inevitably jeopardize their protection as the parties normally exclude the application of the Civil Code's franchise provisions.

Under Hungarian franchise law there is no mandatory pre-sale franchise disclosure rule since there is no provision concerning formal requirements of the pre-contractual information duty concerning franchise agreements either in the Civil Code or other laws of the country.<sup>70</sup> On the other hand, the Civil Code recognizes the doctrine of '*culpa in contrahendo*', hence the parties have the obligation to cooperate, respect each other's interests and inform each other all essential circumstances with regard to the contract during or before the conclusion of the contract. But there is no guidance from the law what constitutes essential circumstances. Even though it is not a mandatory legislative act, the Hungarian Franchise Association (HFA) Code of Ethics states that franchise agreements essential circumstances include: the licensing of know-how, commercial

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<sup>68</sup> The Hungarian Civil Code of 2013.

<sup>69</sup> Péter Rippel-Szabó and Bettina Kövecses, 'The Franchise Law Review Hungary' (The Law Reviews, 27 February 2018) <<https://thelawreviews.co.uk/chapter/1166111/hungary>> accessed 18 May 2020.

<sup>70</sup> The International Comparative Legal Studies, 'Hungary: Franchise 2020' (ICLG 21 September 2019) <<https://iclg.com/practice-areas/franchise-laws-and-regulations/hungary>> accessed 18 May 2020.

appearance, trademarks, the franchise fee, and royalties to be paid, and duration and termination of a contract.<sup>71</sup> Even though it is difficult to speak certainly what kind of information should be disclosed, the franchisor is expected to disclose essential circumstances about the franchise agreement based on '*culpa in contrahendo*' principle. Admitting the fact that this principle could help the franchisee in tort claims over cancellation or misrepresentation of pre-contractual circumstances, it is difficult to describe this as disclosure rule since it not is explicit franchise disclosure requirement. Since Hungary has no explicit statutory provision on the formal requirements of the pre-contractual information duty concerning franchise agreements which is an important tool to protect franchisees.

Regarding the relationship aspect of franchise regulation, the parties are free to choose whether they intend to conclude a contract for a definite or indefinite period and conditions of termination as the Civil Code does not contain mandatory provisions on the termination of franchise agreements which could not be substituted by agreement of the parties since the provisions of the Civil Code in relation to termination of the contract are default rules and therefore can be negotiated individually by the parties.<sup>72</sup> With regard to franchise contracts concluded for an indefinite period of time, the Civil Code sets forth specific rules of procedural nature which the parties may agree otherwise. Franchise contracts made for an indefinite period may be unilaterally terminated by one of the parties effective as of the last the day of the calendar month concerned and the notice period is one month in the first year of the agreement, two months in the second year, three months in the third and following years.<sup>73</sup> It should be noted that the franchise rule in

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<sup>71</sup> *ibid.*

<sup>72</sup> The Hungarian Civil Code of 2013.

<sup>73</sup> Section 6:381, the Hungarian Civil Code of 2013.

the civil code is default rules and they should be enforced by the parties themselves in our case by the franchisor and franchisee.

With regard to registration requirements the Civil does not incorporate a provision which deals with registration of franchise agreement. Even one of the components of franchise, trademark, is subject registration, franchise agreements are not subject to registration in Hungary.<sup>74</sup> Generally, the Hungarian franchise legislative framework failed to provide a legislative guarantee for franchisees as there is no explicit statutory provision that could protect franchisees.

## 2.5 The Protection of Franchisees in South Africa

The southernmost tip of the African continent, South Africa, as a developing economy has harnessed the power of emerging technologies and systems including franchising to foster economic growth which ultimately has helped it remain competitive in today's world. According to a report in 2018, there are around 865 franchise systems and from an estimated number of 45,000 stores, most of which are owned by the franchisees (80%).<sup>75</sup> The total number of people employed in the franchise systems in South Africa is estimated at 370,000 and the estimated turnover of 721 billion South African Rand<sup>76</sup> for the franchising industry is equivalent to 15,7% of the total South African GDP.<sup>77</sup>

It has been stated that the growing contribution of a franchise to South African economy has influenced the government to adopt a Consumer Protection Act ("Act") on April 24, 2009, the act has codified franchise practices which have been advocated by the Franchise Association of South

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<sup>74</sup> The Law Reviews (n 70).

<sup>75</sup> The Franchise Association of South Africa, 'Annual Report 2018' FASA Report 2018, <<https://www.fasa.co.za/reports/FASA-2018-annual-report.pdf>> accessed 18 May 2020.

<sup>76</sup> Which is estimated at around 34,973,380,521 Euro or and 37,848,365,065 USD.

<sup>77</sup> FASA Report 2018 (n 78).

Africa which were lobbying for the adoption of the law.<sup>78</sup> Even though this makes South Africa a country without franchise-specific legislation, but many aspects of franchising are covered in the Consumer Protection Act.

Even though it seems impossible to relate the regulation of franchise and apartheid, the content of the main legislative instrument for the regulation of franchise in South Africa has been influenced by the objective of addressing the problems created by apartheid. At first glance it appears the law seeks to remedy two issues that primarily affect black South Africans: high illiteracy and low business ownership. The South African shift to more regulation in the area of consumer protection can be explained with the historical backdrop of apartheid. As one could grasp from the preamble of the act the has the objective of remedying the sins of apartheid and any residual effects apartheid might have on current business practices within the country.<sup>79</sup> One of the ways the law wants to achieve this objective is by treating franchisees as consumers.

A unique notable feature of franchise regulation in South Africa and a mechanism of protecting franchisees is the inclusion of franchisees in the definition of consumers.<sup>80</sup> Specifically, the act deemed the following arrangements or agreements a transaction between a supplier and consumer; *“a solicitation of offers to enter into a franchise agreement; an offer by a potential franchisor to enter into a franchise agreement with a potential franchisee; a franchise agreement or an agreement supplementary to a franchise agreement; and the supply of any goods or services to a franchisee in terms of a franchise agreement.”*<sup>81</sup> As a result of the designation of franchisees as consumers, franchisees enjoy a bundle of rights designed to “promote and advance the socio-

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<sup>78</sup> Robert W. Emerson, ‘Franchisees as Consumers: The South African Example’ (2014) 37 FILJ 455.

<sup>79</sup> South African Consumer Protection Act 68 of 2008.

<sup>80</sup> Section 1 of the Consumer Protection Act.

<sup>81</sup> Section 5(6)(b) to (e) of Consumer Protection Act



economic welfare of consumers in South Africa”<sup>82</sup> “including honest dealing, fair value, good quality, safety, privacy, choice, information, fair and responsible marketing, supplier accountability, and equality.”<sup>83</sup>

Another important tool in the South African Consumer Protection Act that is aimed at protecting franchisees is a cooling-off period. This suggests that a "franchisee may cancel a franchise agreement without cost or penalty within 10 business days after signing such agreement, by giving written notice to the franchisor."<sup>84</sup> As far as the franchisee is acting within the cooling-off period the cancellation could be made without costs and penalties even the notice is not required to be in writing. This will give the franchisee the opportunity to reevaluate and re-assess whether committing the time, money, and resources worth building a franchise during the cooling-off period.<sup>85</sup>

With respect disclosure rule<sup>86</sup> the law puts disclosure obligation on the franchisor. Every franchisor is required to provide a prospective franchisee with a disclosure document with a minimum of 14 days prior to concluding the franchise agreement.<sup>87</sup> The disclosure document should be comprised of information on the number of individual outlets franchised by the franchisor, the growth of the franchisor's turnover, net profit, statement confirming that there has been no material change in the franchisor's financial position, written projection if potential sales. This is an additional set of rights for the protection of franchisees.

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<sup>82</sup> Section 3(1) Consumer Protection Act

<sup>83</sup> Emerson (n 79).

<sup>84</sup> *ibid*, 466.

<sup>85</sup> *ibid*.

<sup>86</sup> The International Comparative Legal Studies, ‘South Africa: Franchise 2020’ (ICLG 21 September 2019 <<https://iclg.com/practice-areas/franchise-laws-and-regulations/south-africa>> accessed 18 May 2020.

<sup>87</sup> South African Consumer Protection Act 68 of 2008.

In light of the orientation of South Africa's franchise regulation, treating franchisees as consumers, and a bundle of right provisions safeguarding the interest of franchisees, South Africa appears to have a robust mechanism of protecting franchisees.

## **2.6 How Should Ethiopia Protect Franchisees**

It is not argumentative that a well-defined legal structure plays an important role in the effective functioning of any kind of business operation and this works well in franchise. A healthy franchising sector requires adequate and appropriate infrastructure to which the legal environment is central.<sup>88</sup> The flip side of it, lack of comprehensive legislation, can lead to greater complexity, ambiguities, and uncertainty which may negatively affect the business and entrepreneurship in a country. This has been also recognized in the Commercial Registration and Licensing Proclamation which states putting in place a modern and fast commercial law that close loopholes in-laws can contribute to economic development.<sup>89</sup> The legislative framework for the regulation of the franchise business in Ethiopia is full of uncertainties and failed to provide any legislative protection for franchisees that are in a contract between unequal parties. Hence, Ethiopia should come up with a comprehensive franchise law that addresses franchise problems.

The protection of franchisees does not necessarily need adopting the US franchise regulation model which has been applauded for having a robust mechanism of protecting franchisees with layers of significant rights aimed at protecting franchisees. The US franchise regulatory works with a strong and sophisticated regulatory body that requires a substantial amount of budget like the Federal Trade Commission (FTC) which Ethiopia does not have and able to afford to have such kind of regulatory bodies at this point in time. The protection of franchisees in Ethiopia does

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<sup>88</sup> Andrew Terry, 'Franchise Sector Regulation: The Australian Experience' (2003-2004) s2003 Lawasia J 57.

<sup>89</sup> Commercial Registration and Business Licensing Proclamation No. 980/2016.

not seem also feasible with industrial self-regulation as the attempts of self-regulation have met with limited success and have been associated with failure of a franchise in some European countries.<sup>90</sup> It has been criticized for lack of transparency and representation of both parties which could not able to provide franchisees with the necessary protection required because of the nature of the relationship.<sup>91</sup> In addition, the model requires the existence of a workable number of franchisees and franchisors to form the franchise association which is the main body for adopting franchise standards and oversee their implementation which is not currently available in Ethiopia. Rather the introduction of franchise rule that could protect franchisees would be a reasonable option.

The first issue that has to be addressed by new franchise legislation is including the protection of franchisees as the main aim of franchise law. As has been explained before, the main reason for having franchise regulation in many jurisdictions is the protection of franchisees which is due to the power and information imbalance between the franchisor and franchisee. One of the important challenges in designing franchise legislative frameworks is to leave the commercial risk to the parties and protecting franchisees by ensuring a balance between the interest of the franchisor and franchisee. But this does not mean that the franchise legislative framework should be concerned only about the protection of franchisees since there are other reasonable policy objectives that the franchise law might want to achieve including: promoting franchise business, protection of franchisors from abusive behavior, and attracting foreign franchisors. Arguably these objectives might come in conflict with the protection of franchisees in some cases.

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<sup>90</sup> Directorate-General for Internal Policies, 'Legal Perspective of the Regulatory Framework and Challenges for Franchising in the EU' (September 2016).

<sup>91</sup> *ibid.*

It looks the Commercial Registration Proclamation and Regulation has been trapped by these conflicting goals and failed to include a single provision that aimed at protecting franchisees. This will leave the franchisee with a risk of abuse by the franchisor who is the dominant party in the franchise relationship. This would create an asymmetric legislative burden on the franchisee and will discourage the franchisees from entering into the franchise industry. Hence, it is important to have a clear aim of protecting franchisees which are supplemented with specific provisions safeguarding the interest of franchisees. It should also be noted the same as the failure of the protection of franchisees could negatively impact on the development of franchise industry, the excessive protection of franchisees is not also a plausible solution as it also has a chilling effect on the franchise industry and decreases franchisors interest to enter into franchising arrangement. The Ethiopian franchise law should also have to be designed in a way it balances between the interest of the franchisor and franchisee when it includes the protection of franchisees.

One important legislative tool that could be introduced in Ethiopian franchise regulation is introducing disclosure rules by the new legislation. The disclosure rule has been used in any jurisdiction including the US and South Africa and it has been applauded for providing effective pre-contractual hygiene as it reduces the information asymmetry between the two parties which is the main problem in the franchise relationship. The disclosure rule ensures that the franchisor and the franchisee entered into franchise arrangement after careful review of the content of the agreement and the resulting relationship and reduces mismatch of expectations between the two parties.

As we have seen in the US and South Africa disclosure rule is a rule which requires franchisors to provide all potential franchisees with a disclosure document consisting of important information to facilitate informed decisions by a franchisee. The Ethiopian franchise law should also include a

provision that requires the franchisor to disclose to the franchisee before entering into a franchising agreement. The types of information considered material in the US franchise rule could be a good reference for Ethiopia disclosure rule. As we have seen the in the previous section the offered franchise, its officers, past and current franchisees, litigation history, any exclusive territory offered, the support available to the franchisee, and cost of initial investment for starting the business are an example of information that is designated as material under the US disclosure law.

In addition, the rule should require the disclosure document to be given to the franchisee before a specified period of time (10, 15, 20) before execution or payment, enable the relevant regulatory authority to take appropriate administrative measures and impose penalties if they failed to comply with a legislative requirement. The law should also prohibit misleading and deceptive behaviors of both parties and give rise to direct personal liability of the franchisor for the inaccuracy of disclosure document and provide a mechanism to apply the rules on foreign franchisors with no physical presence or permanent establishment in Ethiopia.

The second set of franchise rules that should be introduced in Ethiopia is relationship rules. The rules should ensure a fair relationship between the two parties. The adoption of mandatory relationship rules should include a requirement of good faith and fair dealing, providing an adequate training regarding the operation of the business, recognizing the right of the franchisee to sell its business, these relationship rules providing a bundle of rights to the franchisee will help in ensuring both parties act fairly to each other and help in protecting the franchisee from the abusive behavior of the franchisor.

The adoption of franchise rules aimed at protecting franchisees could be criticized could on the grounds that the adoption of these rules encroaches into a private contractual relationship and will become very restrictive for franchisors and discourage them from entering the Ethiopian market

and the laws could be a reason for more litigation creating legal uncertainty. Even though it is true that the adoption of rules protecting franchisees could encroach into private matters, the unequal bargaining power between the two parties is a compelling reason for compromising freedom of contract and protection of franchisees. If every aspect of the franchise agreement is left to the parties the imperfections in the franchise agreement will have a deleterious effect upon prospective foreign franchisees and upon franchise industry that could benefit from a secured and stable legal framework that balances the interest of the two parties. A franchise legislative framework without adequate for the protection of the weak party in franchise arrangement will hamper the development of the franchise industry in the country and represent an obstacle for the country's economic development and expansion.

On the contrary, adopting franchise rules providing adequate protection for franchisees would help in reducing the inherent power and information imbalance between the two parties and address abuses within the sector. This will boost market confidence among prospective franchisees and promote enterprise development and contribute to the expansion of franchising and business in Ethiopia.

## **Conclusion**

Business format franchise which is relatively new to Ethiopia is gaining approval among Ethiopia business community as one form of doing business. The Ethiopia franchise industry has a big potential to grow as foreign franchisors are interested in the market and Ethiopian franchisees are attracted to the business model. In a tenable move, the business model has also attracted the attention of Ethiopian legislator which enacted a law which provides rules regarding franchise for the first time in Ethiopian legislative history. Despite the effort of the legislator being admirable the general legislative framework for the regulation of franchise business is not inadequate to govern the industry and has failed to provide single legislative protection for franchisees which is the main concern of franchise regulation in many jurisdictions.

The main concern for franchise legislative framework in most jurisdictions is the protection of franchisees which has been neglected in the Ethiopia franchise law. The need to protect franchisees comes from the inherent nature of the franchise relationship in which there is an asymmetry of power and information between the franchisor and franchisee which leads to opportunistic behavior and practices by the franchisor. Hence, the regulation of franchise is most in reducing the asymmetry and tackling the abusive behavior of the franchisor.

The United States in which the business format emerged has one of the robust systems of protecting franchisees with its layers of rules protecting franchisee which ensures the ex-ante and ex poste protection of franchisees. These are disclosure, registration, relationship rules, and administrative agency entrusted with the enforcement of franchise regulation. Hungary which has historical similarity with Ethiopia does not have specific legislative protection for franchisees though it has nominated franchise agreements in its 2013 Civil Code. South Africa protects franchisees by

treating consumers as franchisees which resulted in bundle rights including the disclosure rule and the cooling-off period.

Ethiopia should follow the examples set by the US and South Africa as the failure of the protection of franchisees could negatively impact on the development of the franchise industry since it discourages franchisees from going into the business sector. The adoption of the rule of protecting franchisees should not also be designed in a way it puts excessive protection of franchisees as it has a chilling effect on the franchise industry. Ethiopia should introduce franchisee protection rule that could be implemented with a less sophisticated administrative capacity. The first franchise rule that has to be introduced in Ethiopia is a disclosure rule which has been applauded for reducing information asymmetry and providing effective pre-contractual hygiene in the US and South Africa. In addition, Ethiopia should also include relationship rules as the rule will help in reducing the power imbalance and ensure a fair relationship. The adoption of franchise rules aimed at protecting franchisees will help the regulation of franchise to avoid uncertainties which in turn will help the business to flourish and entrepreneurship to grow to contribute to the country's economy.



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