

**BUSINESS FORMAT FRANCHISING IN MALAWI: HOW SHOULD THE LAW
REGULATE BUSINESS FORMAT FRANCHISES IN MALAWI?**

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DEDICATION

To my brother, Caphaus Chigoneka. I hope I made you proud. I hope you smile today.

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First and foremost, I am grateful to God for taking me this far. Thank you for making it happen for me.

I wish to extend my sincerest gratitude to my husband, Pawene who put aside his own hopes and goals for me to pursue this LL.M. I am forever indebted to him for his sacrifice and unwavering support. Thank you for being present for me and our son. And to my little boy who waited patiently and cheerfully for mommy, thank you.

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ABSTRACT

Franchises are becoming more and more widely recognized as a successful business model with the potential to contribute to economic growth, especially for developing economies such as Malawi. The model allows the franchisor to expand their business to a new territory without the associated financial risk while the franchisee starts a new business on an established and successful business model, without having to suffer the common failures of start-up businesses. For the franchisor, the cost of this opportunity is that he must not only share very sensitive information on which the success of its business is built, but he must also ensure that the franchisee maintains the quality standards and protects the integrity of the brand. The franchisee on the other hand, invests a dear sum into a business model on the strength of promises of success over which he has very limited control and knowledge. While Malawi is yet to enact any business format franchise law, many other countries have recognized the unique vulnerability of the parties to a franchise and use the law to protect each party against abuse by its counterpart.

If at all Malawi should be able to exploit the business format franchise as a tool for economic growth, the legal and regulatory environment for franchising in the country must be made conducive for both parties and ensure optimal performance of the system. This paper seeks to examine the Malawian legal framework for franchises and its strengths and weaknesses in securing the interests of franchisors and franchisees. It particularly highlights the position of the franchisee as the weaker party in franchise agreements and advocates for a balanced approach in the protection of the parties. Drawing from the more developed franchise law jurisdictions of California, Germany and South Africa, the paper adopts a normative and prescriptive analysis based on the principles of fairness and efficiency to explore the possible solutions which may be tailored for franchise law in Malawi.

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LIST OF ABBREVIATIONS

BGB	Bürgerliches Gesetzbuch (German Civil Code)
BHG	Handelsgesetzbuch (German Commercial Code)
CFIL	California Franchise Investment Law
CPA	Consumer Protection Act
CFRA	California Franchise Relations Act
DFV	Deutscher Franchiseverband e.V.).
FASA	Franchise Association of South Africa
FTC	Federal Trade Commission
FDD	Full Disclosure Document
SA	South Africa
SME	Small and Medium Scale Enterprises
US	United States of America

INTRODUCTION

THE BUSINESS FORMAT FRANCHISE AS A TOOL FOR ECONOMIC GROWTH

Franchises have gained increasing popularity as a tool for investment and business in the world. In the United States, the total output for franchises in 2021 was \$787 Billion and it was projected to continue rising.¹ In South Africa, franchising contributed 15% to the country's GDP (around \$358 billion) in 2022 and was estimated to continue rising.² It has been suggested that the business format franchise can be used by Government policy-makers to foster economic growth in developing countries.³ The obvious benefit of business format franchises for franchisees, and in particular, small and medium scale enterprises (SMEs), is that a franchisee can gain skills and experience in a business context where their (initial) lack of skills and experience would have been a handicap.⁴ Through such transfer of skill, training and experience, businesses built on existing and proven successful models have proven to have a higher chance of success than those set up from scratch.⁵

Franchising has been suggested as a more sustainable development solution than aid as it bypasses the lack of political will by African leaders to develop their countries.⁶ However, most developing countries rank poorly in terms of attractiveness as a destination for US business franchises.⁷ Castrogiovanni argues that government action is needed to enhance the munificence of business environments in developing countries by implementing and enforcing

¹ Christina Niu, '2022 Franchising Economic Outlook' (International Franchising Association) <<https://www.franchise.org/sites/default/files/2022-02/2022%20Franchising%20Economic%20Outlook.pdf>>.

² Franchise Association of South Africa, 'The Power of Franchising..Contributing to the South African Economy' (*Franchise Association South Africa*, 17 November 2023) <<https://www.fasa.co.za/the-power-of-franchising-contributing-to-the-south-african-economy/>>accessed 17 June 2024.

³ Gary J Castrogiovanni and George S Vozikis, 'Foreign Franchisor Entry into Developing Countries: Influences on Entry Choices and Economic Growth' (2000) 3 *New England Journal of Entrepreneurship* 9 <<https://www.proquest.com/docview/231141710/citation/52D28F9DED8C48D3PQ/1>> accessed 30 March 2024.

⁴ *ibid.*

⁵ *ibid* 14.

⁶ McCoy Roger, Social Franchising and its Impact in Africa. https://www.researchgate.net/profile/Roger-Mccoy/publication/329921898_Social_Franchising_and_Its_Impact_in_Africa_-_AISA/links/5c239484a6fdccfc706b0945/Social-Franchising-and-Its-Impact-in-Africa-AISA.

⁷ Castrogiovanni and Vozikis (n 3).

laws designed to protect franchisors and their franchisees.⁸ It comes as little surprise that South Africa cashes the highest from franchise agreements and that it is also one of, if not the only country in Africa with a fully-fledged franchise law. It is followed closely by Kenya, which has also made significant attempts to improve its franchise law. Of course, the success of franchising depends on understanding any country's local environment and how it affects franchisors and franchisees.⁹ The efforts of this paper are dedicated to understanding franchising law in Malawi and discovering the “*sweet spot*” for franchise law and regulation in the country.

STATEMENT OF THE PROBLEM

Through the creation of jobs, transfer of skills or collection of taxes for the local budget, the business format franchise presents an opportunity for economic growth. In order to fully exploit that opportunity, Malawi needs to take very deliberate and targeted action with regard to the law and regulatory framework of franchises. However, as is the case in most African jurisdictions, Malawi's franchise law remains largely undeveloped. There are some general laws in Malawi whose application may be extended to franchises, but the absence of a franchise-specific law creates uncertainty for franchisors as to the requirements for the establishment and operation of franchises or the protections available for them in the country. The franchisee on the other hand gambles their investment on the supposed success of a business they know little about. In the absence of any controls and protections, the franchisee is extremely vulnerable and at the mercy of the franchisor. The success of the model depends on the success of the franchise relationship which can only be attained when each party feels adequately protected and finds the arrangement rewarding. There is thus the need to investigate

⁸ *ibid.*

⁹ Simon Sigwe, 'The Promises of Franchising in Africa: The Need for a Critical Examination' 13 *Journal of African Business* 161, 5 <<http://dx.doi.org/10.1080/15228916.2012.734756>>.

the kind of laws required in order to achieve the highest possible protection for both franchisee and franchisor in Malawi without limiting the efficiency of the franchise system.

RELEVANCE OF THE STUDY

The importance of foreign investment in a developing economy like Malawi cannot be over-emphasized and if there is anything to be learnt from countries such as South Africa and Kenya, it is that the business format franchising can be an invaluable asset to economic growth. While this is widely agreed, there has not been any research into the laws of Malawi in particular and how the law can be used as a tool for the exploitation of the business format franchise model. It is hoped that this research will begin to fill that gap and incite actionable research to steer Malawi towards a more structured business format franchising system.

METHODOLOGY AND LIMITATIONS

The paper adopts a qualitative research analysis of franchise law in Malawi in comparison to internationally prevailing standards. Due to time limitations, the Author has chosen to limit the research to the franchise laws of the State of California, Germany and South Africa as the benchmark for comparison. California has a very well developed and strict franchisee protection law while Germany has managed to protect franchisees and regulate franchises without having to adopt a franchise-specific law. South Africa has the most successful system of franchises in Africa and is geographically closer to Malawi. Even though all these countries are much more developed economically than Malawi, it is hoped that their laws hold some lessons which may be applied to Malawi. That said, wherever necessary for the context of Malawi, lessons may be drawn from other jurisdictions.

Data will be collected through desk research. The author will examine the franchise relationship in general and the weaknesses and strengths thereof for both franchisor and franchisee. We will then examine Malawian statutes, regulations and any case law to identify the strengths and vulnerabilities of the current business format franchising system in Malawi

particularly with regard to disclosure and registration laws or laws regulating aspects of the relationship generally. The analysis will be based on the general principles of fairness and efficacy of the laws and the system for both the franchisor and the franchisee. The research will then examine the disclosure and registration laws and the franchise relationship laws of the State of California, Germany and South Africa to establish how, if at all, the vulnerabilities identified in the Malawian system have been addressed. The paper concludes with some prescriptions for a possible franchise law regime in Malawi.

The author anticipates that there will be challenges obtaining access to franchise contract agreements in Malawi to establish practice due to time constraints and confidentiality issues. A survey may have been an ideal approach to establish common practice but this cannot be done due to time and cost constraints on the part of the author. Further, there has not been much litigation or research on the subject in Malawi so there is insufficient research or case law to inform some of the underlying assumptions of the research. For these reasons, this research is only meant to be foundational and may be used to inform further research.

STRUCTURE

The first chapter of this research will focus on familiarizing the reader with the subject of the research. It will discuss the general nature of a business format franchises; the advantages and the disadvantages of the system for both franchisee and franchisor and the interests of both parties. The discussion will then centre on the franchise law of Malawi focusing on disclosure or registration requirements, Intellectual Property laws and the franchise relationship laws on termination/non-renewal, dispute settlement and choice of law clauses and encroachment.

The second chapter will explore the disclosure, registration and franchise relationship laws of the US and the state of California and the lessons and caveats for Malawi. The third chapter will discuss Germany and South Africa and the lessons to be drawn for Malawi and then the

final chapter will conclude with a proposed model for franchising in Malawi which balances the interests of the franchisor and the protection of the franchisee as the weaker party.

CHAPTER ONE: FRANCHISING IN MALAWI: LEXI LATA AND LEXI FERENDA

1.1. INTRODUCTION

For every person, starting anew is scary business. An entrepreneur will typically lose a few bucks trying to enter the market or learning to establish themselves as a reliable brand. Even for an established business, with all its expertise and reputation, conquering new territory is a daunting task, shrouded in uncertainty and risk of failure to penetrate the new market. The established business has expertise and goodwill which the new entrepreneur does not have while the entrepreneur has knowledge of his environment and the market needs. The business format franchise bridges this divide and offers to the entrepreneur: a solid, foolproof business plan as a franchisee while promising to alleviate the risk of loss to the established business as franchisor. It is a uniquely attractive business solution which has continued to gain popularity across the globe, Malawi included. In fact, it is argued that franchises can contribute to economic growth even in developing countries¹⁰ but only when supported by franchise-friendly legal and regulatory intervention which reflects the spirit of franchising itself.¹¹

In Malawi, even though franchising is becoming more prevalent, the industry is often overlooked both in terms of law and research. This chapter seeks to explore business format franchising law as it is (*lexi lata*) in Malawi; the benefits and challenges thereof and the role of law in addressing those challenges. The discussion begins by establishing a general understanding of the very concept of business format franchises before diving into franchising in the Malawian context with special focus on the business relationship between the franchisor

¹⁰ Mark Abell (ed), *The Franchise Law Review* (2014) 129.

¹¹ Nicolas Sireau, *Microfranchising / How Social Entrepreneurs Are Building a New Road To* (first, Routledge 2017) <<https://www.taylorfrancis.com/books/edit/10.4324/9781351278720/microfranchising-nicolas-sireau?refId=1698d357-85a7-4db4-8520-f94d1a296315&context=ubx>> accessed 30 March 2024.

and franchisee and the risks innate in franchising. The chapter will conclude by identifying the main areas of the franchise law which shall be the focus of the paper.

1.1. WHAT IS A BUSINESS FORMAT FRANCHISE?

A franchise can take one of three forms; a product franchise, a manufacturing franchise and a business format franchise.¹² In a product franchise, the franchisor supplies their product and grants an exclusive right of resale to a retailer within a specific area while in a processing or manufacturing franchise, the franchisee is given specifications and the right to reproduce and sell the franchisor's product.¹³ This paper concerns itself with the third category of franchises where the franchisor provides the franchisee with a comprehensive "business format" at a fee, typically consisting of an initial deposit and royalties. There is no unified definition of a business format franchise but there are features which are commonly used to identify a business format franchise.

Mendelsohn lists several features of a business format franchise.¹⁴ Firstly, he states that it arises from a relationship out of an agreement in which a franchisor, who has developed a successful business format which is identified with a brand name (trademark/service mark or trade name), initiates and trains the franchisee in all aspects of the business format so that the franchisee is equipped to run the business effectively. Secondly, the franchisee owns their own business but is, at the continuous supervision and direction of the franchisor and at a fee, permitted to operate the business under the franchisor's branding and benefit from the goodwill associated therewith.¹⁵ These features are reflected in the United States' Federal Trade Commission (FTC) Rule which defines a franchise by three elements: the right to operate a business under the franchisor's trademark, the franchisor's control over the method and quality of operation of the

¹² Elizabeth Crawford Spencer, *The Regulation of Franchising in the New Global Economy* (Edward Elgar 2010) 48–49.

¹³ *ibid.*

¹⁴ Martin Mendelsohn, *The Guide to Franchising* (Continuum 2001).

¹⁵ *ibid.*

business and a payment by the franchisee to the franchisor or its affiliate for the rights so granted.¹⁶ Albeit coined differently, the definition of a franchise agreement in section 1 of the South African *Consumer Protection Act*, 68 of 2008 (CPA) also includes the elements of the right to use the franchisor's trademark and business model at a fee and in accordance with the direction of the franchisor.

In Malawi, section 2 of the *Franchising and Dealership By-laws* made under Section 47 of the *Liquid Fuels and Gas (Production and Supply) Act* defines a franchise as “*a privilege or right officially granted by a franchisor holding a wholesale licence under the Act to a franchisee whereby the franchisee is granted the right to use a trademark, trade name, logo, advertising mark, service mark, major brand, commercial symbol or other identifying symbol or name owned by the franchisor in connexion with the retail sale of liquid fuels or gas supplied by the franchisor*”. While this definition maintains the feature of trademark usage, it does not explicitly include the key elements of franchisor control and payment of fees. It seems to describe a product franchise arrangement and not a business format franchise. For our purposes, a business franchise format includes all the elements discussed above. It is an arrangement where the franchisee pays for the right and the means to trade and operate as though he were the franchisor himself. While some of the discussion may be applicable to product or manufacturing franchises, any reference to franchises in this paper must be understood as reference to business format franchises.

¹⁶ 16 CFR Part 436 Disclosure Requirements and Prohibitions Concerning Franchising s 1(h).

1.2. FRANCHISING IN MALAWI

There is no research to indicate the extent of economic contribution of the franchise industry to Malawi's GDP but business franchises are certainly gaining popularity on the market. For instance, the fast food market is dominated by international franchises such as Steers, KFC, Pizza Inn, Galitos, Creamy Inn, Mug & Bean etc. Supermarkets and convenience stores such as SPAR, GAME stores, Foodlovers market also occupy a fair share of the market. Most of the franchises are South African brands as Malawi doesn't fare too well as an attractive destination for the United States and other western countries. In a study measuring the attractiveness of countries as franchise destinations for US businesses, the country was ranked number 120 out of 143 countries.¹⁷ This study was based on several variables including legal and regulatory framework risk on which variable, the country was ranked number 114/143 by the world Bank Global market Index in 2009.¹⁸ There has not been much development in the franchising law and regulatory field since then. What then is the law on franchises in Malawi?

1.3. FRANCHISE LAW IN MALAWI

As it has already been alluded to, there is no franchise-specific law in Malawi. We considered whether franchises are provided for under competition laws or consumer protection laws as is in other jurisdictions such as South Africa. However, the Malawian Consumer Protection Act, defines a consumer as a person who *“purchases or offers to purchase technology, goods or services otherwise than for resale; but does not include a person who purchases any technology, goods or services for the purpose of using them in the production or manufacture of any other technology, goods or services for sale”*.¹⁹ Technology has been defined as including *“systematic knowledge or a transaction involving the transfer of systematic*

¹⁷ E Hachemi Aliouche and Udo A Schlentrich, 'Towards a Strategic Model of Global Franchise Expansion' (2011) 87 Journal of Retailing 345 <<https://www.sciencedirect.com/science/article/pii/S0022435911000054>> accessed 1 April 2024.

¹⁸ Ibid

¹⁹ Section 2 of the Consumer Protection Act.

knowledge for the manufacture of a product, for the application of a process or for the rendering of a service and does not extend to the transactions involving the mere sale or mere lease of goods".²⁰ A franchisee does not qualify as a consumer under this Act because it is not in the same category as "goods or services". While transfer of business knowledge is a crucial part of the franchise package, what the franchisee buys is the licence to trade under the trademark or brand of the franchisor. Even if the franchise were to be accepted as *systematic knowledge for the provision of goods and services*, the definition of a consumer under the Consumer Protection Act expressly excludes any person who "*purchases any technology, ... for the purpose of using them in the production or manufacture of any other technology, goods or services for sale.*"²¹ The franchisee is not a consumer and cannot claim the rights of a consumer under the Consumer Protection Act.

The Competition and Fair Trading Act also excludes application to franchises. In Section 3(d) and (e) of the Act, it is stated that:

"3. Nothing in this Act shall apply to—

(d) those elements of any agreement which relate exclusively to the use, licence or assignment of rights under, or existing by virtue of, any copyright, patent or trademark;

(e) any act done to give effect to a provision of an agreement referred to in paragraph (d);

With the exception of the oil and gas industry, franchises in Malawi are purely a matter of contract law. In the oil and gas industry, section 6(2) of the Liquid Fuels and Gas (Production and Supply) Act requires that a wholesaler only operates a maximum of two retail outlets and

²⁰ Ibid

²¹ Section 2 of the Consumer Protection Act

franchises the rest to Malawians. There are franchising and dealership by-laws made under this statute which apply to the franchises so created. These by-laws are not applicable to franchises in any other industry except oil and gas. As discussed above, the definition of franchise under that Act seems to refer to product or manufacturing franchises. However, reference will still be made to the franchising regulations under the Liquid Fuels and Gas (Production and Supply) Act (hereinafter referred to as the Liquid Fuels Act) only to demonstrate the level of protection offered to franchisees when there is a franchise-specific law.

1.3.1. Franchising and Intellectual Property Law in Malawi

At its very core, franchising is a trade in intellectual property assets such as brand names, patents, and trademarks that can be misused by opportunistic franchisees if not adequately protected.²² Franchisors are creators of system-specific knowledge and initiate the growth of networks of franchised outlets while franchisees are recipients of this knowledge and have to replicate it under local conditions.²³ A discussion of franchise law in Malawi would thus be incomplete without discussing the protection of the intellectual property rights in Malawi.

Malawi signed and ratified the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement. It is also a member of the African Regional Intellectual Property Organisation (ARIPO) and has domestic legislation for the protection of Copyrights, Trade Marks and Patents. A franchisor can register their trademark under the Trademarks Act and once registered, they can take out any action against infringement of the same.

Violation of IP rights in franchising are not a common problem for Malawi hence the lack of case authorities on the point. Albeit not reported, there were complaints for violation by South

²² Aliouche and Schlentrich (n 8) 349.

²³ Nina Gorovaia, 'Knowledge Transfer in Franchising' in Frank Hoy, Rozenn Perrigot and Andrew Terry (eds), *Handbook of Research on Franchising* (Edward Elgar Publishing 2017) 234 .<<https://china.elgaronline.com/view/edcoll/9781785364174/9781785364174.00022.xml>> accessed 6 April 2024.

African franchising companies, Foodlovers market and Diplomats Car Hire, against local Malawian businesses which were trading under those names. Both cases were settled before trial. It may not be a commonly litigated area but if a franchisor with a registered trademark were to sue for violation of IP rights, the law is in place and the enforcement mechanisms available for him to obtain reliefs including injunctions, damage for infringement or costs. The Malawian legal system recognises, protects and enforces intellectual property rights.

1.4. BENEFITS OF FRANCHISING IN MALAWI

1.4.1. Advantages of Franchising for the Franchisor

The benefits of franchising as a business model generally ring true for franchising in Malawi as for anywhere else. First and most importantly, the franchise system enables rapid, steady growth with reduced exposure to business risk.²⁴ Doherty quotes a top executive of franchisor company saying, “*..there is one big factor that makes us want to franchise and that is you don't tie up the capital – we tie up someone else's capital*”.²⁵ A franchisor who wishes to expand but does not have the financial capacity for it can still expand at a lower cost through franchising. The franchisee contributes to the capital of the franchisor by making an initial payment at the commencement of the franchise and continues to make payments throughout the tenure of the agreement. The costs of the venture, including rentals, operating assets, workforce and all associated costs are covered by the franchisee. Instead of having to spend money hiring and training workers in a company setting, the franchisor is essentially “*paid*” to train the franchisee’s workers. The franchisor also tends to subsidise the cost of advertising as by pooling together contributions from franchisees for advertising. For these reasons, franchising is generally cheaper for the franchisor than expanding through a company owned enterprise.

²⁴ Spencer (n 12) 51.

²⁵ Anne Marie Doherty, ‘The Internationalization of Retailing: Factors Influencing the Choice of Franchising as a Market Entry Strategy’ (2007) 18 International Journal of Service Industry Management 184 <<https://doi.org/10.1108/09564230710737826>> accessed 7 April 2024.

Secondly, the enterprise is not as demanding on the franchisor for resources. The franchisee owns their own business and tends to be more highly motivated than a company-employed manager as such franchised locations do better than company-owned locations in both revenues and profitability.²⁶ The franchisor need not break a sweat about motivating their employees or stimulating efficiency, the franchisee is as invested in the success of the franchise as the franchisor himself. In Malawi, moreover, the franchisor has unfettered freedom to frame the contract as restrictively or as liberally as they please. That gives them a lot of control over the franchisee.

Lastly, the franchisee takes over the operational and market risk which would have otherwise been borne by the franchisor such as compliance risks, financing, employment problems, or contractual obligations.²⁷ Malawi's economy is very unstable and no market research can guarantee success. The franchisor does not bear that risk with a franchise.

1.4.2. Advantages of franchising for the franchisee

The selling point for the franchise system is that the franchisee owns their business but can escape the exigencies of establishing a successful business as they get a business model that is already tried and proven. They operate under the name and reputation (brand image) of the franchisor, which is already well established in the mind and eye of the public.²⁸ The franchisor may also provide training and support throughout the relationship to ensure the success of the brand. Franchising is a unique opportunity for a new business to gain competitive advantage in a competitive market.

The franchisee can also save some costs on advertising and procurement of supplies. The franchise has professionally designed local, regional, and national advertising and marketing

²⁶ Rupert M Barkoff and others (eds), *Fundamentals of Franchising* (Fourth edition, American Bar Association, Forum on Franchising 2015) 62.

²⁷ Doherty (n 25).

²⁸ Spencer (n 12) 61.

programs which continuously improve brand visibility at a fraction of the cost since it is funded by resources pulled by all the franchisees. The franchisor may have negotiated lower prices from suppliers for the supplies needed for the franchise and may have rebates from suppliers that the franchisee can also benefit from.²⁹ Smaller businesses usually do not have such negotiating powers. The franchisee also benefits from the wealth of research and development into new products and services developed through the franchise.

1.5. THE CHALLENGES OF FRANCHISING IN MALAWI

The Malawian franchise market has seen some failures. To begin with, Debonairs pizza, a South African franchise recently closed in Lilongwe, the capital city. SPAR's first franchisee in Malawi drowned in debt and not only closed its stores but was also forced into liquidation.³⁰ Before its inevitable closure, the South African franchise Debonairs, in the city of Blantyre was shut down together with Steers by the Malawi Bureau of Standards for failure to meet hygiene standards.³¹ KFC also failed to meet minimum waste management standards in Lilongwe, and was shut down by the Lilongwe City Council.³² Nandos, another South African franchise, also closed down in Lilongwe as the food failed to meet the Nandos standards. I can say with absolute certainty that the fries at Cross Roads shopping complex in Lilongwe do not taste the same as steers fries from any other steers in Malawi or South Africa. Without any empirical studies, it is hard to attribute fault to either party for the lack of uniformity of standards but it is quite clear that the challenge of maintaining standards in franchises exists in Malawi, to the

²⁹ Peter C Lagarias and Edward Kushell, 'Fair Franchise Agreements from the Franchisee Perspective' (2013) 33 Franchise Law Journal.

³⁰ Ttadmin, 'The Malawian High Court Orders Supermarket Chain PTC to Be Put into Receivership' (*Trendtype*, 10 October 2022) <<https://trendtype.com/news/the-malawian-high-court-orders-supermarket-chain-ptc-to-be-put-into-receivership/>> accessed 1 April 2024.

³¹ Bright Malenga, 'Steers, Dairiboard Shut down! Malawi 24 | Latest News from Malawi' (*Malawi 24*, 20 June 2016) <<https://malawi24.com/2016/06/20/steers-dairiboard-shut/>> accessed 1 April 2024.

³² 'Lilongwe City Council Closes KFC | Malawi 24 | Latest News from Malawi' <<https://malawi24.com/2020/08/10/lilongwe-city-council-closes-kfc/>> accessed 1 April 2024.

detriment of both parties. The franchisor's brand integrity is compromised while the franchisee loses their investment.

1.5.1. Disadvantages of franchising for the franchisor

As one might expect, franchising comes at a cost to the franchisor too. By putting its brand and business model in the hands of the franchisee, the franchisor loses some control over the business and exposes it to franchisee opportunistic behaviours such as free-riding, disclosing confidential information or trade secrets to third parties or withholding information from the franchisor.³³ Franchisees may try to free-ride on the efforts of other outlet managers to increase short-term profits and, over time, increase their independence and autonomy.³⁴ The franchisee may unilaterally terminate the contract after securing knowledge transfer from the franchisor and start a similar business and with more or less the same commercial assets.³⁵ He may refuse to pay ongoing fees as soon as the business no longer requires critical support from the franchisor. More commonly, franchisees adapt to their local contexts so much that they deviate from the chain's standardized know-how and even alter the nature of the franchise concept.³⁶ Maintaining the required level of uniformity for the franchise system is one of the most difficult challenges for franchisors.³⁷ In a vertically integrated chain, the owner has sufficient control to dictate every single operational detail and ensure compliance but a franchisor cannot dictate the minutiae of day-to-day operations for its franchisees.³⁸ It is thus crucial for the success of

³³ Assâad El Akremi, Karim Mignonac and Rozenn Perrigot, 'Opportunistic Behaviors in Franchise Chains: The Role of Cohesion among Franchisees' (2011) 32 Strategic Management Journal 930 <<https://onlinelibrary.wiley.com/doi/abs/10.1002/smj.912>> accessed 14 April 2024.

³⁴ Ilan Alon, 'Global Franchising and Development in Emerging and Transitioning Markets' (2004) 24 Journal of Macromarketing 156 <<https://doi.org/10.1177/0276146704269320>> accessed 15 April 2024.

³⁵ Sigue (n 9).

³⁶ El Akremi, Mignonac and Perrigot (n 33).

³⁷ Patrick J Kaufmann and Sevgin Eroglu, 'Standardization and Adaptation in Business Format Franchising' (1999) 14 Journal of Business Venturing 69 <<https://www.sciencedirect.com/science/article/pii/S0883902697000979>> accessed 13 April 2024.

³⁸ Barkoff and others (n 26) 63.

the model that the franchisor be allowed the freedom to dictate some aspects of the business which are considered crucial for the integrity of the brand such as suppliers or recipes.

Secondly, although not as high as running a subsidiary company, there is still some cost associated with advertising, registration of trademarks, selling and running the franchise. A franchisor has to acquire equipment and skilled personnel to operate various aspects of franchising including maintaining uniformity of standards, selling the franchises or training the franchisees.³⁹

Thirdly, franchising limits the franchisor's rights to innovate, as well as adjust quickly and effectively to market changes. Any changes in the business format have to be made across all of the franchisees and the franchisees may sometimes be resistant or unable to meet the cost of the innovation.⁴⁰ The cost of the risk devolved to the franchisee is that the franchisor must share the proceeds of the business with the franchisee. The franchisor only gets a percentage of the profits of the business in royalties and must allow the franchisor to take the chunk of the profit.

1.5.2. Disadvantages of franchising for the franchisee

1.5.2.1. Power Asymmetry

For the franchisee, franchising is a double edged sword. The benefit of trading under a well-established business model and brand is also the root of all the franchisee's challenges. On top of selling the product, the franchisor is also in the business of selling the franchise. They have experience, knowledge and financial resources which the franchisee cannot match. Almost all the terms of engagement are decided by the franchisor and given to the franchisee without any room for negotiation.⁴¹ This puts the franchisee in a weaker position and leaves them vulnerable

³⁹ Barkoff and others (n 26).

⁴⁰ *ibid* 89.

⁴¹ Kaufmann and Eroglu (n 37).

to opportunistic behaviours by franchisors.⁴² There is thus, inherent in the franchisor-franchisee relationship, a power asymmetry. A commentator described it as “power franchising” through “heavily one-sided contracts that lock the franchisee into an unknown future determined by the unilateral decisions of the franchisor”.⁴³ In the Malawian context, where franchises are left solely to the common law of contract, this asymmetry is apparent at every stage of the agreement and manifests itself as information asymmetry, unfair termination or non-renewal terms, encroachment, unfair choice of law or judicial forum selection.

Information asymmetry refers to situations of interaction between two parties in which one has more relevant pieces of information than another.⁴⁴ At the formation stage, the prospective franchisee requires accurate and sufficient information regarding the structure, economics and performance of the sector and the franchise in particular.⁴⁵ The franchisor has all that information but may not always be willing to provide it. The investigations leading up to the adoption of the FTC Rule in the US established that due to information asymmetry, get-rich-quick schemes, false earnings claims, and a general informational imbalance between franchisor and franchisee, among other issues, were prevalent.⁴⁶

Malawian law acknowledges the problem of information asymmetry in franchising and addresses it in the Franchising and Dealership bylaws by requiring a franchisor in the oil and gas industry to provide a disclosure document to the prospective franchisee at least 30 days before signing of a franchise agreement.⁴⁷ The disclosure document must contain information

⁴² Peter C Lagarias and Robert S Boulter, ‘The Modern Reality of the Controlling Franchisor: The Case for More, Not Less, Franchisee Protections’ (2010) 29 Franchise Law Journal 139 <<https://www.jstor.org/stable/29542276>> accessed 3 June 2024.

⁴³ Andrew C. Selden, Organizational Design for Successful Franchising, 20 FRANCHISE L.J. 1 (2000) quoted in Lagarias and Kushell (n 29) 7.

⁴⁴ Yakoub Salhi, ‘A Framework for Measuring Information Asymmetry’ (2020) 34 Proceedings of the AAAI Conference on Artificial Intelligence 2983, 1 <<https://ojs.aaai.org/index.php/AAAI/article/view/5691>> accessed 18 April 2024.

⁴⁵ Spencer (n 12) 6.

⁴⁶ Statement of Basis and Purpose, 43 FR 59621 (Dec. 21, 1978)

⁴⁷ Section 12(1) of the Franchising and Dealership By-laws under the Liquid Fuels and Gas (Supply and Production) Act.

to help the franchisee make a reasonably informed decision about the franchise and current information that is material to the running of the franchised business.⁴⁸ Examples of the required information include earning projections, pending litigation which may affect the trademark use, other franchisees, experience of the franchisor, indemnity and guarantees applicable to the franchise, etc. The Franchisee has a duty not to disclose the contents and in those 30 days, he is mandated to seek independent counsel to help him understand the contract. The contract is only signed when the franchisee certifies that he understands the contract and that he has sought counsel or waived his right to do so.

For franchises in other industries, there is no positive duty of disclosure, at least for the time being, so a franchisee could purchase a worthless franchise and still not be able to recover their investment. No remedies would lie for failure to disclose unless it can be proved that the franchisor misrepresented himself or acted in bad faith.

1.5.2.2. *Opportunistic behaviours by franchisors*

The franchisor ordinarily sets the tone of the franchise relationship. The terms can be so one-sided that some have criticised the system for dehumanizing franchisees for the sake of efficiency.⁴⁹ Storholm and Scheuing conducted interviews to identify perceived sources of conflict at the instance of the franchisor.⁵⁰ In that survey, franchisees reported that the franchisor forced them to purchase supplies from the franchisor which could be sourced for less elsewhere. The franchisor would sell supplies to the franchisees or require that purchases be made from verified suppliers, with whom the franchisor had some loyalty or benefits program. The franchisor would either sell their supplies at a profit or get lower prices for itself from every purchase by its franchisees at the cost of the franchisees.⁵¹ It is indeed true that

⁴⁸ Section 13 of the Franchising and Dealership By-laws

⁴⁹ Alon (n 34).

⁵⁰ Gordon Storholm and Eberhard E Scheuing, 'Ethical Implications of Business Format Franchising' (1994) 13 Journal of Business Ethics 181, 8 <<https://www.jstor.org/stable/25072521>> accessed 16 April 2024.

⁵¹ Storholm and Scheuing (n 52).

standardisation of products is important but if not controlled, efforts to maintain the business standards may be motivated by selfish gains by the franchisor.

Along with the royalties, advertising monies are also directed to the franchisor.⁵² These funds are earmarked to advertise and promote the franchise but they are left at the sole control of the franchisor rendering them vulnerable to abuse, much to the detriment of the franchisee. The franchisor may allocate the resources for advertising within its own area to the detriment of the other franchisees.

1.5.2.3. *Termination and non-renewal*

At the beginning of the franchise relationship at a new location, the franchisor does not have sufficient information to determine the prospects of success for the franchise at that location. At that point, a contract is entered into and the franchisee bears much of the risk of failure for that location. In time, the location proves successful and the franchisor realises they can make more money by redirecting and operating a company-owned business in that area or with more franchisees so they want to terminate the contract or simply not renew it when it expires. In the Storholm study, franchisees reported unfair terminations of franchises.⁵³ Whatever the motivation for termination or non-renewal, the franchisee is yet again, at the mercy of the franchisor and utterly powerless to get a return on their investment.

Cognizant of the franchisee's lack control over the tenure of the relationship, the Franchising and Dealership Bylaws require that in case of termination other than by expiry of the term of the contract, a 90-day notice accompanied by the grounds of such termination be provided.⁵⁴ The Bylaws provide that if the termination is on grounds of breach by the other part, the offending party must be given a reasonable opportunity to remedy the breach. If the franchisor

⁵² *ibid* 184.

⁵³ Storholm and Scheuing (n 52).

⁵⁴ Section 16 of the Franchising and Dealership By-laws made under s47 of the Liquid Fuels and Gas (Production and Supply) Act

does not wish to renew the contract, he is also under an obligation to notify the franchisee of such decision and the grounds thereof at least 90 days before the termination of the franchise. Section 18(5) of the by-laws states that unless such a notice is served, the “*franchisor shall not refuse or fail to renew the franchise agreement*”. The franchisee may institute proceedings appealing the decision if it considers that the grounds are not fair and equitable. Again, these limitations are not applicable to business format franchises where once a contract expires, there is no duty to renew.⁵⁵

1.5.2.4. *Dispute Resolution and Choice of Law*

As a franchisor expands, he seeks the least expensive and most efficient way to scale up. The legal and regulatory environment of franchises is taken into account when making that decision. If they can avoid expensive regulatory requirements and extensive limitations of their freedom to dictate the terms of their contract, business logic dictates that they will avoid it. Similarly, the franchisor favours jurisdictions whose laws are more favourable for them. This is often reflected in forum selection and choice of law clauses in the franchise agreement. A franchisor often requires venue and the law in the state where its headquarters is located⁵⁶ but can sometimes choose a forum to which neither party is connected. For the franchisee, the expenses of travel, legal fees in that country or licensing their local counsel may be prohibitive. At common law, the general rule is that the Courts will secure compliance with an exclusive jurisdiction clause unless the party suing in a non-contractual forum can show strong reasons for using in that Court.⁵⁷ The fact that costs are prohibitive, without more, is not sufficient for the Court to override the contractual choice of law.⁵⁸ Unless he can show that there is no

⁵⁵ Ibid (n54)

⁵⁶ Lagarias and Kushell (n 29) 24.

⁵⁷ Donohus v Armco Inc. [2002] 1 Lloyd's Rep. 425

⁵⁸ The Registered Trustees of Blantyre Health Research and Training Trust vs John Hopkins University. Commercial Cause No. 160 of 2020. (Unreported).

connection between any of the parties and the chosen jurisdiction, the franchisee would be bound to the chosen law, even if it deprives them of some benefits.

In Malawi, the problem was recognised and addressed for franchises in oil and gas. The By-laws require that all disputes be referred to arbitration at the Energy Regulatory Authority.⁵⁹ Section 9 also declares void, any obligation on the franchisee “*that is likely to be impossible or unreasonably onerous to perform at the time when it is required to be performed*”.⁶⁰ A choice of law or forum provision can thus be challenged on the grounds that it is unreasonably onerous to perform. For franchises in other industries however, such a remedy does not exist and the Court will enforce the terms of the contract. See the case of *Mtalimanja Holdings v. Fertinvest DMCC* where the Plaintiff’s argument that the Court in Malawi assume jurisdiction because arbitration seated in London, as stipulated in the contract, would be too expensive for them.⁶¹ The Court decided that the Plaintiff was aware of the expenses even at the time of the agreement and could not be allowed to turn around on his commitment.

1.5.2.5. Encroachment

Lastly, there are issues of encroachment or cannibalisation. This results from placing franchises too close together such that one franchise siphons customers from the other or one offers products that the other does not offer.⁶² It is solely up to the franchisor to decide whether to sell more franchises, maintain his current franchisees or compete with the franchisees. The final decision however, has such a great influence on franchisees that it may render their once-profitable business useless. Storholm narrates the fate of a franchisee who was forced to sell his business at a near loss because the franchisor opened another franchise one mile away from

⁵⁹ Ibid (n52) §21

⁶⁰ Ibid (n52) §9

⁶¹ *Mtalimanja v. Fertinvest DMCC* commercial case No. 481 of 2021. (Unreported)

⁶² Lagarias and Kushell (n 29) 13.

him to punish him for sourcing from cheaper sources.⁶³ The new franchise diluted his business so much that he simply could not remain in business.

1.6. FRANCHISING IN MALAWI: DE LEGE FERENDA

The basic and overriding principle of contract law at common law and in Malawi, is that “*parties must be bound by agreements they have freely made.*”⁶⁴ For this reason, Courts in Malawi uphold the terms of a contract unless the agreement is illegal or contradicts public policy. The same logic is extended to franchise agreements and they would be readily enforced in Courts according to their terms. However, the franchisees are undoubtedly weaker in terms of economic, organisational, legal and commercial power,⁶⁵ often being presented with a “*take it or leave it*” kind of contract which can hardly be negotiated.⁶⁶ By failing to recognise the power asymmetry in franchising relationships, franchise law in Malawi - at least on the level of written law - is tipped quite heavily in favour of the franchisor leaving the franchisee vulnerable to abusive or opportunistic behaviours by the franchisor. A franchise-conducive environment should, however, also offer some protection to the franchisee and not just the franchisor. Enforcement of contracts is available in Malawi through Court or arbitration so this paper will limit its discussion to contractual freedom and intellectual property protection as the overarching interests of the franchisor which need to be balanced with efforts to protect the franchisee from abusive conduct resulting from the power asymmetry in franchise relations.

⁶³ Storholm and Scheuing (n 52) 184.

⁶⁴ Landell Mills Associates Ltd. V Marshall. 14 MLR 175 at p.179

⁶⁵ Wojciech Czakon, ‘Power Asymmetries, Flexibility and the Propensity to Coopete: An Empirical Investigation of SMEs’ Relationships with Franchisors’ (2009) 8 International Journal of Entrepreneurship and Small Business - Int J Enterpren Small Bus 6.

⁶⁶ Robert W Emerson, ‘Fortune Favors the Franchisor: Survey and Analysis of the Franchisee’s Decision Whether to Hire Counsel’ (2014) 51 San Diego Law Review 747.

1.6.1. Contractual freedom

The franchisor will try to structure their franchise relationships to reduce potential franchisee opportunism.⁶⁷ Opportunistic behaviour ranges from wilful evasion of contractual obligations to franchisee's calculated and harmful opportunistic behaviour which harms the brand.⁶⁸ The law should allow the franchisor enough freedom to adopt as many measures as necessary to protect the brand from harmful franchisee opportunistic behaviours.

If limitations should be imposed on the freedom to contract, they should be reasonable and serve legitimate purpose. It is in the interests of both parties that any regulations do not impale the efficacy of the system.

The underlying assumption for any successful franchising agreement is that the terms of a franchise contract are binding for both the franchisor and franchisee country's legal system is strong enough to effectively enforce these terms if a party fails to meet its contractual obligations.⁶⁹ The franchisor not only wants to be able to control the terms of their agreement but to be assured that the terms will be enforced, if and when required.

1.6.2. Information asymmetry

As already alluded to, the franchisee can only make an informed decision on franchising when they have been provided with all the relevant and sufficient details of the business. The franchisee should be able to rely on the law to demand disclosures but even more so, the law should compel disclosure of certain information considered crucial to the franchisee's decision. These laws are often referred to as disclosure and registration laws. Disclosure laws require franchisors to disclose to potential franchisees specific, material information that would highly

⁶⁷ Scott A Shane, 'Why Franchise Companies Expand Overseas' (1996) 11 Journal of Business Venturing 73 <<https://www.sciencedirect.com/science/article/pii/0883902695001107>> accessed 14 April 2024.

⁶⁸ El Akremi, Mignonac and Perrigot (n 33) 125.

⁶⁹ James A Brickley and Frederick H Dark, 'The Choice of Organizational Form The Case of Franchising' (1987) 18 Journal of Financial Economics 401

affect the franchisee's decision of whether to invest and registration rules require registering disclosure documents with the competent governmental agency.⁷⁰

1.6.3. Dispute settlement

In case of disputes, most franchise contracts would have a clause indicating the governing law and the method of dispute settlement, typically mediation, arbitration or litigation in a certain jurisdiction. As stated, the choice will ordinarily have been made by the franchisor and it is important for the law to ensure that dispute settlement clauses offer accessible and effective remedies for the franchisee as well.

1.6.4. Encroachment

Since all the franchisees offer the same products, encroachment onto the franchisee's territory may compromise their business prospects or force them out. The law should protect the franchisee against encroachment and cannibalisation.

1.6.5. Termination or non-renewal

It is important that termination of franchise relationships be fair and reasonable. Some sort of security of tenure for the contract must be guaranteed, at least long enough to allow the franchisee to recoup their investment.

1.7. CONCLUSION

A franchising contract has, inherent in its nature, a power asymmetry in favour of the franchisor. The franchisee is usually weaker economically and strategically. The terms of the franchise are largely dictated by the franchisor and imposed on the franchisee whose freedom to contract is heavily compromised by the lack of information and resources. In Malawi, franchising is left entirely to the law of contract. The country recognises intellectual property

⁷⁰ Radwa Elsaman, 'Disclosure and Registration Requirements in Franchising: Common Law or Civil Perspective?' (29 August 2023) <<https://papers.ssrn.com/abstract=4556041>> accessed 20 April 2024.

laws and guarantees protection of all registered trademarks while at the same time offering unlimited freedom to the franchisor to dictate the terms of the franchise. In the Oil and gas Industry, the laws recognise the imbalance of power in the relationship and puts in place measures to regulate the relationship and encourage fair franchising. In every other industry however, the franchisee is left vulnerable to abusive and opportunistic behaviour by franchisors including; encroachment, unfair termination or non-renewal, unfavourable dispute settlement and forum selection clauses, exploitative pricing and tying of supplies. While the legal environment seems friendly for the franchisor, there is need to balance the scales and put in measures that protect the franchisee from exploitation. The next chapters will focus on how to regulate these areas of franchising for the Malawian context.

CHAPTER TWO: FRANCHISING IN THE STATE OF CALIFORNIA

2.1. INTRODUCTION

Recognising the need for protection is one thing and it is quite another thing entirely to determine the nature and extent of protection to be achieved by what regulation. In the case of Malawi, the fact that franchising is still in its infancy presents a unique opportunity to tap into the experiences of other jurisdictions and draw important lessons to shape the law and regulation of franchises in Malawi. This chapter sets the tone for the search for a balanced franchise law in Malawi by diving into the franchise law of California, one of the oldest and most franchisee protective jurisdictions in the world. The chapter will briefly discuss the development of franchise law in California and then discuss how California has dealt with the challenges of information asymmetry and franchisor and franchisee opportunistic behaviour in franchising.

2.2. FRANCHISEE PROTECTION IN CALIFORNIA

Franchise law was born in the United States of America from years of experiences with a franchising regime characterised by complete freedom of contract.⁷¹ The business model itself emerged in the mid 1800's but it was not until 1970 that the first law regulating franchising emerged, indeed, in State of California.⁷² Representatives from the State Department of Justice began compiling statistics on franchise fraud and misrepresentation sometime in 1969 and found that fraud and misrepresentation were rampant in the industry. They cited examples including misrepresentation of investment requirements; adequacy of training programs; profit projections; promised supervision and assistance; supply purchasing advantages; and

⁷¹ Donald P Horwitz and Walter M Volpi, 'Regulating the Franchise Relationship' (1979) 54 St. John's Law Review 217 <<https://heinonline.org/HOL/P?h=hein.journals/stjohn54&i=227>> accessed 19 May 2024.

⁷² Honey V Gandhi, 'Franchising in the United States' (2014) 20 Law and Business Review of the Americas 1, 5.

advertising and promotional help.⁷³ There were several lawsuits filed against the franchisors pointing to the *"pervasive power of franchisor control" over the disclosure of information; ease of entry into the franchise industry, coupled with the lack of adequate capital and/or experience among franchisees; undefined franchise relationship terms regarding termination, cancellation, and renewal of the contract; or simply the widespread exploitative practices adopted by the franchisor.*"⁷⁴

Although several Bills had been introduced in the House of Congress, none of them had materialised into law at the Federal level until California adopted its disclosure and registration law, the California Investment Law, in 1970.⁷⁵ A disclosure law requires pre-sale disclosures before selling a franchise while registration laws require that the disclosure document be registered with a regulatory authority before the franchise is offered for sale.⁷⁶ California's CFIL is both a disclosure and registration law which requires franchisors provide franchisees with a Full Disclosure Document (FDD) and also register the offering before the sale of any franchise in California.⁷⁷ Many of the disclosure provisions that followed in various States and at Federal level patterned after the California Franchise Investment Law.⁷⁸ At the federal level, the Federal Trade Commission (FTC) followed suit in 1979 with the enactment of the "Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures", the FTC Rule which only requires disclosure but not registration.

⁷³ *Interim Hearing on Franchises before the Senate Insurance and Financial Institutions Committee*, November 7, 1969 as cited in Franklin L. Damon, 'Franchise Investment Law' (1971) 2 Pacific Law Journal 27, 29 <<https://heinonline.org/HOL/P?h=hein.journals/mcglr2&i=39>> accessed 19 May 2024.

⁷⁴ Gandhi (n 74) 6.

⁷⁵ Horwitz and Volpi (n 71).

⁷⁶ Barkoff and others (n 26) 143.

⁷⁷ Section 31101 and 31110 Franchise Investment Law, Division 5, Added to Title 4 of the Corporations Code of the State of California by Stats. 1970. Ch. 1400.

⁷⁸ Horwitz and Volpi (n 71) 249.

Franchise relationship laws are statutes that mainly govern the ongoing relationship between franchisors and franchisees⁷⁹. The California Franchise Relations Act was enacted in 1980 with the sole purpose of addressing the unequal bargaining power between franchisors and franchisees particularly in relation to termination and non-renewal of franchise agreements.⁸⁰ The California Franchise Investment Law (CFIL) and the Franchise Relations Act (CFRA) have been amended a few times since their enactment, to provide further protection for franchisees. The cumulative result of these two acts, backed up with several court cases, is that California is deemed to be the most franchisee-protective jurisdiction in the US, with protections extending both to the pre-contractual and the post-contractual phase.

2.3. DISCLOSURE AND REGISTRATION LAWS

Franchisor opportunistic/deceptive conduct can occur at the granting or selling the franchise, in the operation phase of the franchise or at the termination of the franchise.⁸¹ Registration and disclosure laws are aimed at specifically addressing deceptive practices in the granting or selling of franchises.⁸² The CFIL combines both registration and disclosure requirements to resolve the problem of information asymmetry and reduce deceptive practices in the granting and selling of franchises. These practices include franchisor's:

- a. Misleading prospective franchisees about the potential profitability of the franchise
- b. Refusing to show the actual profit and loss statements to prospective franchisees
- c. Having hidden charges in the prices franchisees are charged for services and supplies

⁷⁹ Robert W Emerson and Uri Benoliel, 'Are Franchisees Well-Informed: Revisiting the Debate over Franchise Relationship Laws' (2012) 76 Albany Law Review 193, 194 <<https://heinonline.org/HOL/P?h=hein.journals/albany76&i=199>> accessed 3 June 2024.

⁸⁰ Horwitz and Volpi (n 71).

⁸¹ Shelby Hunt and John Nevin, 'Full Disclosure Laws in Franchising: An Empirical Investigation' 40 Journal of Marketing 53, 53 <https://www.jstor.org/stable/pdf/1251006.pdf?refreqid=fastly-default%3Abcec0a0d1266d36e0326b67bc88ae063&ab_segments=&origin=&initiator=&acceptTC=1> accessed 19 May 2024.

⁸² *ibid* 54.

- d. Using a celebrity's name to deceptively promote the franchise
- e. Overpromising on their aids to franchisees and;
- f. Using high pressure tactics in closing the sale of the franchise.⁸³

California's CFIL makes it mandatory for every franchisor to register franchise offerings before offering it for sale.⁸⁴ The registration is done with the State Commissioner of Securities and must include a prospectus with the following information:

- a. Disclosure of the background of the principals involved with the franchisor (especially any felonies committed by the principals)
- b. Recent financial statement
- c. Sample franchise contract
- d. Policy of the franchisor concerning franchise fees, royalties, and supplies
- e. Contract termination provisions
- f. Terms and conditions of any financial arrangements
- g. Substantiation of any profit projections in pro forma statements
- h. Disclosures relating to using the name of a public figure
- i. Number of franchises presently operating and proposed to be sold, and
- j. Territorial protection given to the franchisee.

The prospectus must be disclosed to the prospective franchisee at least 14 days prior to execution or receipt of consideration.⁸⁵ If there are any changes to the offering, the franchisor

⁸³Shelby Hunt, 'Full Disclosure and the Franchise System of Distribution' in Dynamic Marketing in a Changing world, Boris W. Becker and Helmut Becker, eds. (Chicago: American Marketing Association. 1973) pp. 301-304

⁸⁴ Section 31110 Franchise Investment Law, Division 5, Added to Title 4 of the Corporations Code of the State of California by Stats. 1970. Ch. 1400.

⁸⁵ § 31119 *ibid.*

is required to make a report of the same and file an application for the alteration of the offering. The CFIL sought to require franchisors to provide franchisees with the “full and complete information” that they needed to make an informed investment decision.⁸⁶ Indeed, studies show that the disclosure laws did in fact result in decreases in deceptive practices and benefited franchisees in their efforts to evaluate franchise investments and screen out undesirable franchise opportunities.⁸⁷

2.4. FRANCHISE RELATIONSHIP LAWS

Franchise relationship laws are designed to address problems stemming from power imbalances, such as territorial rights, termination or renewal issues which arise after the sale of the franchise.⁸⁸ The CFRA was aimed at regulating franchise relationships, protecting franchisees, and promoting fair business practices. Out of the four key issues selected for discussion in this paper, the CFRA covers termination, non-renewal and dispute settlement. Interestingly, the CFRA does not make provision for encroachment.

2.4.1. TERMINATION AND NON-RENEWAL

The CFRA Prohibits a franchisor from terminating franchise prior to the expiration of the term except for good cause.⁸⁹ Good cause is limited to the failure by the franchisee to substantially comply with the lawful requirements imposed upon them by the franchise agreement after being given notice of at least 60 days in advance of the termination and a reasonable opportunity to cure the failure.⁹⁰

⁸⁶ William L Killion, ‘The Modern Myth of the Vulnerable Franchisee: The Case for a More Balanced View of the Franchisor-Franchisee Relationship’ (2008) 28 Franchise Law Journal 23, 27 <<https://heinonline.org/HOL/P?h=hein.journals/fchlj28&i=23>> accessed 19 May 2024.

⁸⁷ Hunt and Nevin (n 81) 61.

⁸⁸ Lagarias and Boulter (n 42) 141.

⁸⁹ California Business and Professions Code, Division 8, Chapter 5.5, Franchise Relations § 20020.

⁹⁰ *ibid*

Immediate notice of termination without an opportunity to cure is deemed reasonable in case of insolvency, failure by the franchisee to operate the business for five consecutive days, agreement by both parties to terminate the franchise, conduct by the franchisee that reflects unfavorably upon the operation, failure by the franchisee to comply with any federal or local regulation after ten days' notice, repeated non-compliance by the franchisee after a notice to cure non-compliance under section 20020 or where continued operation would result in imminent danger to public health and safety.

Once the agreement is terminated, the franchisor is required to purchase from the franchisee all inventory, supplies, equipment, fixtures and furnishings etc. which were used in the franchise business.⁹¹ Application of this section can be excluded in some circumstances including where the parties mutually agree to terminate or where the franchisor does not prevent the franchisee from retaining the place of business.

If, upon expiry of the franchise agreement, the franchisor does not wish to renew the contract, he must provide the franchisee with at least 180 days' prior written notice of intention not to renew. Additionally, it must also;

- a. Permit the franchisee to sell his business to a purchaser who meets the franchisor's conditions for the grant of a franchise, within the notice period; or
- b. The refusal to renew is based on circumstances on which termination would be justifiable under Section 20021 and it is not for the purpose of appropriating the business premises for its own account. The franchisor agrees not to seek to enforce any covenant of the non-renewed franchisee not to compete with the franchisor or franchisees of the franchisor or;
- c. Both parties agree not to renew.

⁹¹ Ibid §20021.

2.4.2. *DISPUTE SETTLEMENT*

Franchisors who do not wish to follow a specific state law have the ability to choose the law of a friendlier forum, and can avoid American law altogether by specifying an overseas forum making the cost of dispute settlement prohibitive or unattainable.⁹² The CFRA recognizes this possibility and allows for Settlement of disputes by arbitration but only on condition that the standards applied are not less than the requirements specified in the Act and that the arbitrators are chosen from a list of impartial arbitrators by the American Bar Association.⁹³ In this way, even if arbitration proceedings are kept private, franchisees are still be protected and can refuse to arbitrate where the law of choice does not meet the requirements of the CFRA.

Arbitration can be prohibitively expensive and even more so where the franchisor chooses a forum out of State or country, making franchise remedies almost illusory. The CFRA prohibits any agreement which restricts the venue to a forum outside the state of California for the settlement of disputes that have arisen in the performance of an agreement operating in California.⁹⁴

2.4.3. *ENCROACHMENT*

The CFRA does not expressly provide for encroachment but claims for territorial encroachment have succeeded on the basis that allowing a competing business to run too close to the franchisee is contrary to the principle of good faith. For example, in *Scheck v Burger King*, the Court held that the franchise agreement had implied into its terms by law, a term that Burger King would not act to destroy the right of the franchisee to enjoy the fruits of the contract.⁹⁵ The Court thus awarded damages to the franchisee where Burger King had allowed the

⁹² Paul Steinberg and Gerald Lescatre, 'Beguiling Heresy: Regulating the Franchise Relationship' (2004) 109 Penn State Law Review 105, 111 <<https://heinonline.org/HOL/P?h=hein.journals/dlr109&i=116>> accessed 4 June 2024.

⁹³ §20040 CFRA

⁹⁴ § 20040.5 CFRA,

⁹⁵ *Scheck v. Burger King*, 756 F. Supp. 543 (S.D. Fla. 1991)

establishment and operation of another Burger King within 2 miles of the Plaintiff's establishment. Similarly, in ***Bryman v. El Pollo Loco, Inc.*** California's superior Court found that El Pollo Loco breached the implied covenant of good faith and fair dealing in its franchise agreement with its existing franchisees when it opened two competing franchisor-owned restaurants close to the franchisees' existing restaurant in Lancaster, California without first offering the franchisees the opportunity to open and operate the two new restaurants.⁹⁶

However, some Courts have refused to imply that the duty of good faith and fair dealing prevents a franchisor from encroachment where the agreement does not grant the franchisee exclusive territory.⁹⁷ In fact, with the exception of the California decision of *Bryman*, the consensus among the courts appears to be that a duty not to encroach cannot be implied where a franchise agreement expressly denies a franchisee an exclusive territory and/or expressly affirms the right of a franchisor to develop new locations in an existing franchisee's territory.⁹⁸

In ***Cohn v. Taco Bell*** the Court decided that the franchisor's "*commitment to use its best efforts to assist the franchisees in day-to-day operation and management techniques and to make all changes in the Defendant's trademarks in good faith does not imply a commitment to shelter the Plaintiffs from competition encouraged by company owned restaurants.*".⁹⁹ Similarly, in ***Burger King Corp. v. Weaver***, the Court of Appeals agreed that the franchisor had not breached the implied covenant by operating a restaurant in a location that was in direct competition with two of the franchisee's restaurants.¹⁰⁰ In that case, Burger King authorized the construction of a competing restaurant close to Weaver's two franchises. The Court held that Florida courts do

⁹⁶ *Handlers-Bryman v. El Pollo Loco*, Case No. B292585 (Ca. Ct. App. Feb. 5, 2019)

⁹⁷ Charles S Marion and others, 'Stepping on Toes: Territorial Rights and Encroachment' (42nd annual Franchise Forum of the American Bar Association) p.15.

⁹⁸ *ibid* 11.

⁹⁹ *Cohn v. Taco Bell*, No. 92 C 5852, 1994 WL 13769 (N.D. Ill. Jan. 14, 1994)

¹⁰⁰ *Burger King Corp. v. texaco*, 169 F.3d 1310 (11th Cir. 1999)

not recognize a claim for breach of the implied covenant of good faith and fair dealing absent a breach of an express contract provision.

2.5. LESSONS FOR MALAWI

For Malawi, California's story illustrates that common law remedies are simply not enough. The duty to act in good faith does not bind the franchisor to full disclosure nor does it provide any remedies for failure to provide all the details about other franchises or ongoing litigation, to name but a few. Instead, registration and disclosure laws have been shown to reduce false advertising and aid franchisees in conducting due diligence before purchasing a franchise.¹⁰¹ Further, the mere requirement that facts be disclosed without more is insufficient. A disclosure law should explicitly specify in as much detail as possible what kind of information should be considered relevant enough to be contained in every disclosure document.

At common law, *"effects of termination were starkly simple-the franchisee would be ousted from the franchise, essentially forfeiting his investment ... the franchisor would then regain full control of the terminated business and would be free to begin a relationship with a new franchisee"*¹⁰² This was illustrated in *Texaco, Inc. v. A.A. Gold, Inc.* where the Court refused to acknowledge that franchise agreements are contracts of adhesion warranting exercise of equitable remedies, stating instead that *"..the court in this case will not indulge itself in such fantasies. It is not its function to guarantee every businessman's success in his enterprise, or to protect him from entering into improvident or ill-advised contracts, or to relieve him from contracts freely negotiated, that prove to be onerous. It cannot be denied that the vitality of our marketplace is derived to a great degree from the time-honored caveat that the individual must*

¹⁰¹ Hunt and Nevin (n 81).

¹⁰² 62B AM JUR 2D Private Franchise Contracts§ 548 (1999) quoted in Steinberg and Lescatre (n 92) 124.

*enjoy the right of "freedom of contract".*¹⁰³ California's express cognisance of the power asymmetry in franchises ensures certainty of outcomes and protects the franchisee from abuse.

California allows arbitration but protects the franchisee by requiring that the arbitrators be independent and that the franchisee be guaranteed the protections provided by law.¹⁰⁴ The law makes it impossible for franchisors to take disputes outside of the State for resolution. This helps franchisees manage costs and obtain effective remedies even when they opt for alternative dispute resolution.

California's provisions on non-renewal ensure that franchisees have better security of tenure and a chance to recover their investment even after the initial contractual term. The fact that the CFRA makes termination and renewal subject to good cause¹⁰⁵ allows franchisees some control over their investment and protects them from unfair terminations and non-renewals.

The lack of encroachment provisions creates uncertainty and may prejudice franchisees and prevent them from making good on their investment. Malawi, could benefit from encroachment provisions but there is some benefit in allowing each case to be considered on its merit. For example, establishing an outlet close to a franchisee may not amount to encroachment where the franchisee cannot service the demand within the area. Malawi may debate, in light of its own unique circumstances, whether the limitations or extent of control taken from the franchisor is excessive or not but California certainly provides a good model on how to balance the power between franchisor and franchisee.

¹⁰³ *Texaco, Inc. v. A.A. Gold, Inc.*, 78 Misc. 2d 1050, 1054 (N.Y. Sup. Ct. 1974)

¹⁰⁴ § 20040 CFRA.

¹⁰⁵ §20020 CFRA.

CHAPTER THREE: CAPITA SELECTA

3.1. INTRODUCTION

Franchise law models have been classified into three categories; the regulatory, the industrial self-regulatory and the private law-based models.¹⁰⁶ The Regulations-based model is characterised by a cocktail of Federal and State law and supplementary Regulations all aimed at preventing abuses by the franchisor.¹⁰⁷ A specialized governmental agency gives effect to the mandatory provisions in administrative proceedings with administrative remedies. The parties may but must not opt to enforce the mandatory rules of a civil code or statute by litigation or arbitrating.¹⁰⁸ Thus far, we have considered an example of this model; California.

Other jurisdictions have what has been termed the self-regulation model whereby the industry regulates itself through a code of conduct or ethics, supplemented by general private and commercial law with or without any additional sector specific law.¹⁰⁹ Germany exemplifies this system with the German Franchise Association Code of Ethics binding all its members in addition to private laws which impact on franchises. Germany makes for an interesting study because even though it does not have franchise specific law, franchises are still quite heavily regulated.¹¹⁰ Closer to home, South Africa also combines a Code of Ethics by the Franchise Association of South Africa with legislation on consumer protection which also applies to Franchises.

Yet another model is the Private law based model which presumes the existence of franchise-specific rules enshrined in civil (or commercial) codes or statutes of equal status and features;

¹⁰⁶ Tibor Tajti, 'Systemic and Topical Mapping of the Relationship of the Draft Common Frame of Reference and Arbitration' [2014] SSRN Electronic Journal 68 <<http://www.ssrn.com/abstract=2512790>> accessed 5 June 2024.

¹⁰⁷ Tajti (n 106).

¹⁰⁸ *ibid* 72.

¹⁰⁹ *ibid* 78.

¹¹⁰ Babette Märzheuser-Wood, 'Germany' in Mark Abell (ed), *The franchise law review* (Law Business Research 2014).

and reliance on private law remedies to enforce franchise obligations.¹¹¹ These systems start from the freedom to contract but recognising the asymmetry of franchise contracts, attempt to strike a proper balance between the contradicting interests of the franchisor and the franchisee. In the case of breach, franchise related provisions are to be enforced by the parties through litigation or court enforcement thus usually provide protection *ex post* as compared to the regulatory based systems. Time constraints prevent separate consideration of such a system as private law remedies are discussed in light of the other two models as well. Hence, this chapter will focus on Germany and South Africa's approaches to the problems of information asymmetry, encroachment, termination, non-renewal and dispute settlement in franchising.

3.2. INFORMATION ASYMMETRY

There is no statute explicitly requiring disclosure by franchisors but German law imposes a general duty of good faith¹¹² and this includes an obligation to disclose all material facts¹¹³ failing which the franchisee may nullify the contract and claim damages under the principle of *culpa in contrahendo*.¹¹⁴ The principle of *culpa in contrahendo* means 'fault in conclusion of a contract' and holds a party liable for leaving the negotiating table or otherwise causing damages or harm to the negotiating partner without a just cause.¹¹⁵ The principle has been expounded as creating a relationship of trust between negotiating parties such that protection is accorded against any blameworthy conduct which prevents the consummation of the contract.¹¹⁶ The fact that the franchisor has information which is superior to the franchisee creates an obligation on the franchisor to disclose that information.¹¹⁷ *Culpa in contrahendo* is invoked and the blameworthy party held liable for the resulting injury because the other party

¹¹¹ Tajti (n 106) 75.

¹¹² Sections 242 and 311 BGB

¹¹³ OLG München, 24.04.2001 – 5 U 2180/00 ("Aufina")

¹¹⁴ Friedrich Kessler and Edith Fine, 'Culpa in Contrahendo, Bargaining in Good Faith and Freedom of Contract: A Comparative Study' (1963) 77 Harvard Law Review 401

¹¹⁵ Tajti (n 106) 41.

¹¹⁶ Kessler and Fine (n 114) 405.

¹¹⁷ Ibid (n 113)

would probably have abstained from entering into the contract if it had been properly informed.¹¹⁸ The information so disclosed should be full and accurate and must be relevant to help the franchisee decide whether or not to buy the franchise.¹¹⁹ The Code of Ethics of the German Franchise Association (DFV) recommends disclosure that the disclosure document contains information about the description and mode of operation of the franchise system, franchise services, profitability, necessary labour and capital investment and summary of franchisor services.¹²⁰

In South Africa, franchisees are considered consumers and franchises are subject to the regulation of the National Consumer Commission under the Consumer Protection Act (CPA).¹²¹ Regulation 3 of the Regulations to the CPA requires that a franchisor provide a franchisee with a disclosure document stating the number of franchises on the chain, certified accurate and updated financial statements and information about individual outlets for the franchisor and the profitability projections of the venture and the basis on which the projections are made.¹²² The franchisor must also certify that they are solvent and that the financials are accurate and prepared in line with prevailing standards of accounting. Finally, the disclosure document must be accompanied by a list of current franchisees and outlets owned by the franchisor.¹²³ The Franchise Association of South Africa (FASA) also compels disclosure and although only binding on its members, issues fines for non-compliance.¹²⁴

There is no general duty for continuing disclosure in both systems but in Germany, the franchisor is under a constant obligation to take care of the counterparty's interests and this

¹¹⁸ Kessler and Fine (n 114) 407.

¹¹⁹ LG München, 16.09.1993 - 6 U 5495/92.

¹²⁰ Märzheuser-Wood (n 110) 276.

¹²¹ Section 1 of the Consumer Protection Act of South Africa, 2009.

¹²² Regulation 3 of the Regulations of the Consumer Protection Act of South Africa.

¹²³ Ibid.

¹²⁴ §4 of the 'Code of Ethics' (*Franchise Association South Africa*) <<https://www.fasa.co.za/about/code-of-ethics/>> accessed 16 June 2024.

could translate to continued disclosure where there are any changes that affect the franchise.¹²⁵

In both systems, disclosure must be written.

3.3. CHOICE OF LAW AND ARBITRATION

The choice of foreign law will be enforced if the contract has sufficient connection to the foreign country. It cannot be enforced where both parties are located in Germany.¹²⁶ The German position is that because franchise agreements are pre-drafted contractual rules provided by the franchisor for multiple franchisees, the contractual rules need to be reasonable and are void if they unreasonably disadvantage the franchisee.¹²⁷ Further, under Section 134 of the BGB, there is a general duty not to violate protective laws. If therefore, the choice of law or any clause puts the franchisee at an unreasonable disadvantage, it can be challenged and possibly, avoided. The same applies to any clauses for arbitration.

South African law does not specifically put any restrictions in relation to choice of law for franchise contracts. This means that Courts are bound to respect a choice of law provision unless it is proved to be unfair, unreasonable or unjust under Section 48 of the CPA, which generally prohibits such. Section 58 gives the Court the power to ensure fair and just conduct, terms and conditions. A clause choosing the law of a country to which none of the parties have a connection could be challenged as unreasonable and the Court may, under section 58, still apply South African law.

3.4. TERMINATION AND NON-RENEWAL

In Germany, if an agreement is entered into for an unlimited period, it can be terminated with cause or without cause, according to the terms stipulated in the agreement while a fixed-term agreement can only be terminated for cause, provided that the franchisee is given prior

¹²⁵ Section 241(2) BGB.

¹²⁶ Märzheuseur-Wood (n 110).

¹²⁷ Sections 305-310 BGB

warning.¹²⁸ With regard to renewals, the franchisor is free to either extend the franchise agreement or refuse to renew it. As stated above, the franchisor has the duty to act fairly towards the franchisee in all circumstances.

South Africa does not have specific provision on termination so the parties are guided by the franchise agreement. There is also no general obligation to renew the contract. Just like any other clause in a franchising agreement, termination or refusal to renew can be challenged as unfair, unreasonable or unjust.

3.5. ENCROACHMENT

The two jurisdictions have a similar approach to encroachment. It is not specifically provided in both jurisdictions. In Germany, section 242 BGB and sections 86 and 86a HGB impose a general obligation to live an agreement according to the requirements of good faith. The obligation of good faith has been held to include protection from competition through other franchisees belonging to the franchise system where the economic existence of the franchisee is permanently endangered by the competing activity of the franchisor.¹²⁹ Again, if the contract was drafted unilaterally and offered to the counterparty on a take-it- or-leave-it basis, any provision which puts the franchisee at an unreasonable disadvantage is contrary to the principle of good faith and would be void. Similarly, in South Africa, encroachment may be challenged as conduct which is unfair, unreasonable and unjust under section 48.

3.6. LESSONS FOR MALAWI

German franchise law is how it so demonstrates that “*unto whomsoever much is given, of him shall be much required*”.¹³⁰ Instead of attempting to exhaustively list down all the ingenious ways in which persons in positions of power can exploit that power for their selfish benefit,

¹²⁸ Mark Kirsch (ed), *Franchise 2022* (16th edn, Tom Barnes) 62.

¹²⁹ Kentucky Fried Chicken, Case No. 16 W 62/11, Higher Regional Court of Düsseldorf, 10 Feb.2020.

¹³⁰ Luke 12 verse 48 of the Christian Bible

German law simply imposes a duty on them to act with utmost faith and fairness in their dealings with others. In case of breach, whatever the form, the law swoops in to remedy and protect the weaker party. This general duty to act in good faith extends beyond simply not acting in bad faith but imposes a positive duty to protect the weaker party. This can be seen in the duties imposed at every stage of the relationship. In the pre-sale stage, even without a statutory requirement for disclosure, the franchisor can still be held liable for failure to disclose information known to it which would influence the franchisee's decision.¹³¹ This would be useful for Malawi and could especially be applied even before the development of specific franchise laws.

The South African franchise law does not create a specialised Agency but brings franchise regulation under the purview of the National Consumer Commission. The Commission does not have powers to adjudicate but may assist in mediating disputes, investigating misconduct or issuing compliance notices.¹³² While the body's mandate may not be as wide as to cater for all the regulatory areas, there is still administrative oversight without the full cost of a specialised oversight body. For an economy such as Malawi, this could be very beneficial.

Both Germany and South Africa, have made it easier to challenge any kind of conduct without needing to have it specifically proscribed under law. German Courts can always examine conduct against the good faith and fair dealings standard while South Africa can test conduct as being unfair, unreasonable and unjust.

¹³¹ Ibid (n 113)

¹³² Section 99 of the CPA

SUMMARY AND CONCLUSIONS

Franchises are relatively new in Malawi and their regulation is left entirely to realm of contract law. However, unlike regular contracts, franchise agreements are marred by power asymmetry in favour of the franchisor as the more powerful party. Consequently, the general principles of contract law are not enough to protect the franchisee who is in a weaker position. By failing to recognise the power asymmetry, the law leaves the franchisee vulnerable to exploitative conduct and unfair terms of contract imposed by the franchisor creating a non-conducive environment for the franchisee. If the franchise industry is to thrive, the asymmetry of franchise contracts is to be accepted and franchisee protection addressed *de lege feranda*. Whatever limitations on the franchisor's powers must also be reasonable and allow the franchisor the freedom to determine the terms on which to contract to maintain and protect the integrity of the brand.

The principle of good faith and fair dealing as used in German law essentially places an obligation on the powerful party to protect the interests of the weaker party as well. While it is often used against the franchisor, it may be used even by the franchisor to hold the franchisee culpable for opportunistic behaviour where the franchisor finds himself in a weaker position. This section summarises the extent of limitations on franchisor's power *de lege feranda* are desirable for the protection for the franchisee.

4.1. INFORMATION ASYMMETRY

At the pre-sale stage, the franchisor has access to information which affects the franchisee's decision whether or not to purchase the franchise. To ensure that both parties are contracting freely, the franchisor must provide all that information to the franchisee hence, the need for disclosure law. For California and South Africa, disclosure is a statutory requirement¹³³ while

¹³³Section 31110 CFIL and Regulation 3 of the Regulations to the CPA

Germany relies on the principle of good faith and *culpa in contrahendo*.¹³⁴ California not only requires disclosure; it also requires registration of the franchise offering with an Agency which has the power to refuse registration if the requirements are not met. Registration offers *ex ante* protection while statutory disclosure alone tends to provide *ex post* protection, often requiring litigation other enforcement mechanism. Franchisees would benefit more from *ex ante* protection but in the case of Malawi, prevention may not be economically viable as it would require the designation or creation of a well-equipped regulatory body to provide oversight and enforcement functions.

A more viable solution for Malawi would be to adopt a law requiring disclosure before the completion of the sale of a franchise, with a list of the information which is considered relevant, such as the financial statements of the franchisor, the numbers of franchises on the system, the required investment, prospective profitability of the venture, supported by documents on which the claim is based and the services offered by the franchisor. Drawing from the German approach, it might also be useful to add, together with the exhaustive list, a provision requiring disclosure of any other information which would affect franchisee's decision of whether or not to purchase the franchise. This would capture any unforeseen documents or information which may not be listed.

4.2. DISPUTE SETTLEMENT

4.2.1. CHOICE OF LAW AND ARBITRATION

Albeit unsuccessfully, the CFRA sought to ban any clause limiting the venue for dispute settlement to a forum outside of California.¹³⁵ Arbitration clauses are enforceable as long as the standards applied are not less than the requirements specified in the Act.¹³⁶ Germany does

¹³⁴ Kessler and Fine (n 114).

¹³⁵ The Supreme Court decided that the ban was pre-empted by the Federal Arbitration Act. See *Viking River Cruises, Inc. v. Moriana* 596 U.S. (2022)

¹³⁶ § 20040 CFRA

not explicitly deal with the issue but does impose a general duty of fairness on the franchisor and provides that any clause which unreasonably disadvantage the franchisee is void.

In Malawi, a choice of law or arbitration clause will be enforceable unless a party can show strong and exceptional grounds which were non-existent and unforeseeable at the time of execution to invoke the Court's discretion not to enforce it.¹³⁷ The fact that litigation or arbitration in the forum of choice is expensive is in itself is not sufficient as exceptional circumstances as it is one which could have been foreseen at the time of execution.¹³⁸ It is very difficult to establish the exceptional circumstances so often times than not, the Court would hold the parties to the terms of the contract.

In my view, a blanket prohibition of choice of law or forum, other than Malawi, would not be ideal. While it is true that some franchisors might opt for a law with the sole purpose of stripping the franchisee of some protections guaranteed in their country of domicile, forum choice is also based on the extent of development of the law of that jurisdiction or fears or uncertainty surrounding the host Country's laws or Court system. A balanced approach should not trivialise those concerns with a complete ban but rather, ensure that even where a different law or forum is chosen, the franchisee is not stripped of the protections under the host State's law. At the same time, a franchisee should be able to challenge the choice on specific grounds, including prohibitively high costs considering the subject matter of the claim and the economic capacity of the franchisee or for the fact that none of the parties have a connection to the selected jurisdiction.

¹³⁷ The Registered Trustees of Blantyre Health Research and Training Trust v. John Hopkins University. Commercial Cause No. 160 of 2020 (Unreported).

¹³⁸ Ibid.

4.3. ENCROACHMENT

Beyond just limiting the freedom to contract, regulating encroachment may have anti-competitive effects as well. Prohibitions or limitations ought to target the intention and effect of actions rather than regulating specific conduct because the same act in different situations will have different effects. Consider for example, a franchisee whose territory is so heavily populated and demand is so high that he cannot meet it and another, whose territory is not as heavily populated. The same act-establishing an outlet in close proximity- would have different effects on the franchisees. However, leaving the matter entirely to contract does create uncertainty and exposes the franchisee to abuse unless some limitations are defined. California and Germany leave the matter entirely to the interpretation of good faith standards and requirements by Court. In both California and Germany, some Courts would decide to allow encroachment if there is no clause in the contract for exclusivity of territory, while other Courts would decide that even in the presence of an exclusivity clause, the principle of good faith prevents the franchisor from encroachment. South Africa would have the conduct challenged as unfair, unreasonable and unjust.

In my view, instead of leaving the matter entirely to contract and interpretation by Courts, Malawi could benefit from clear legislation defining and prohibiting encroachment, whether or not there is an exclusivity clause.

4.4. TERMINATION AND NON-RENEWAL

Most franchise agreements tend to have termination clauses allowing termination of the agreement with notice, and without any reason. Franchise law will either allow termination by the franchisor with notice or prohibit it completely and instead require that termination by the franchisor be done only on valid grounds. In this regard, the CFRA presents the best model for termination of franchises; it requires that good cause be shown and that the franchisee be given

a 60-day notice to cure the non-compliance complained of. At the same time, it provides a list of exceptions allowing the franchisor to terminate without the cure notice.

With respect to refusal to renew, California is still commendable as it places an obligation to renew which is discharged if there is good cause for termination or at the option of the franchisor. Imposing a duty to renew the contract unless there is a good reason not to renew it would be ideal for Malawi.

4.5. NOTE TO LAW-MAKERS

To encourage the growth of the franchise industry, Malawi needs to be able to protect the franchisees from the negative effects of the power asymmetry inherent in franchise agreements. At the same time, the franchisor's freedom to determine the terms of the agreement and the best way to protect and grow the brand should not be unreasonably limited because it is that creativity that enabled the franchise model to thrive. This paper concludes that a law which creates a trust relationship between the parties and binds them to a duty of good faith and fair dealing throughout the formation, operation and termination of the relationship is ideal for Malawi. Such duty should be supplemented by specific statutory prescriptions defining minimum requirements for protection of franchisee interests through termination, encroachment, choice of law or arbitration clauses which are considered fair.

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