

# **Franchising as a Tool for Business Growth in Georgia: What Comparative Law Can Offer**

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Global Business Law and Regulation LL.M. Final Thesis

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## **AUTHOR’S DECLARATION**

I, the undersigned, Mariam Arsenidze, Candidate for the LL.M. degree in Global Business Law and Regulation, declare here with that the present thesis titled “Franchising as a Tool for Business Growth in Georgia: What Comparative Law Can Offer” is exclusively my own work, based on my research and only such external information as properly credited in notes and bibliography.

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Vienna, 15 June 2025.

Mariam Arsenidze

## Abstract

Franchising is a successful worldwide business model that creates jobs, promotes innovation, boosts entrepreneurship and, in turn, fosters economic growth. The problem is that, in Georgia, this business model is underdeveloped, among other reasons, due to various legal and regulatory challenges that stymie its organic development, although franchising is already a relatively widely known business model. Both, international and local franchise systems are already operating in the country. The Civil Code of Georgia only includes eight non-detailed articles on franchising, which fail to regulate key aspects of the franchising system and the franchisor-franchisee relationship. This creates unclear rights and obligations, weak legal protections for both parties, and a lack of guidance for resolving disputes. For these reasons, this thesis is primarily focused on the legal aspects of franchising in Georgia, rather than its economic aspects.

More specifically, the thesis aims to highlight the importance of finding a proper legal balance between franchisors, who seek to protect their intellectual property and business models, and franchisees, who need sufficient autonomy and legal protection to operate successfully. A proper balance increases the potential to create jobs, encourage investment, and support small business development, while also addressing these legal challenges and incorporating insights from court decisions, which are relatively few in Georgia. The study will provide policymakers and legal practitioners with actionable recommendations for developing a comprehensive franchising framework.

The thesis begins with an examination of the law on franchising in Georgia and compares it with best practices in jurisdictions that have well-established legal frameworks. The top model for analysis in this thesis is the United States, specifically the Federal Trade Commission (FTC) Franchise Rule, as well as the regulations of the State of California, which are among the most franchisee-protecting systems. Besides California, key cases and the accompanying regulations

of a few other U.S. states will also be examined. Furthermore, a closer examination will also be conducted of the European Union, France, and Germany - the latter being a major civil law jurisdiction that has served as the primary model for Georgia in the past. By analyzing how these systems define and regulate the rights and obligations of franchisors and franchisees, the thesis will identify practical lessons that could be adapted to Georgia's legal system to reduce the asymmetry problem between the parties. The objective is to propose reforms to the Georgian legal framework that ensure clear and balanced provisions, fostering trust and cooperation between the parties.

Lastly, the thesis will argue that improving the legal provisions governing franchising in Georgia is essential to unlocking its full potential. Drawing on doctrinal analysis, relevant case law, and business practice insights, the thesis demonstrates that a well-defined and balanced legal framework can make franchising a more reliable and effective business model. Such a reform would significantly contribute to the country's entrepreneurial landscape and create new opportunities for both local and international businesses.

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## TABLE OF ABBREVIATIONS

Abbreviation	Definition
U.S	United States of America
Cal.	California
EU	European Union
E. G	For Example
FDD	Franchise Disclosure Document
FTC	Federal Trade Commission
CFIL	California Franchise Investment Law
CFRA	California Franchise Relations Act
DFPI	Department of Financial Protection and Innovation
VBER	Vertical Block Exemption Regulation
EFF	European Franchise Federation
UNIDROIT	International Institute for the Unification of Private Law
ECJ	European Court of Justice
BGB	German Civil Code

## Introduction

### 1.1. The Franchise-Economic Growth Nexus

Franchising is a business expansion strategy that involves a licensing agreement. Licensing is the core, but there are also elements of other agreements that are important. Under this agreement, the franchisor, whether an individual or a company, grants the franchisee a license to conduct business under the franchisor's brand and trademarks. Franchisees, the recipients of this license, are required to offer specific products and services, the features and contents of which are determined by the franchisor. Additionally, the franchisor provides brand recognition and ongoing support to the franchisees.<sup>2</sup> This has become a highly successful way of doing business around the world. Franchising helps people start their businesses, encourages new ideas, and boosts the economy.<sup>3</sup> By using franchising, companies can grow quickly by working with local partners, known as franchisees, who are familiar with their area. This makes franchising a key part of how businesses operate today.<sup>4</sup> This is also the primary justification behind this thesis, which aims to explore how franchising could be boosted in Georgia, the author's home country, for the benefit of the country's economy.

As business relationships evolved, the creativity of entrepreneurs and the growing demand for certain products led to the rise of franchising to connect businesses. As more goods and services became available to consumers, the reputation of the brand, the methods used to deliver products or services, and brand recognition became increasingly important. Building a good reputation,

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<sup>2</sup> The International Franchising Association <https://www.franchise.org/franchising-overview/what-is-a-franchise/> accessed 09.03.2025.

<sup>3</sup> Philip F. Zeidman, "With the Best Intentions: Observations on the International Regulation of Franchising," Stanford Journal of Law, Business & Finance 19, no. 2, Spring 2014, p.244.

<sup>4</sup> What is Franchising? (In Simple Terms) <https://www.fibrenew.com/blog/what-is-franchising/#:~:text=Franchising%20allows%20businesses%20to%20grow,a%20cost%20Deffective%20growth%20s,ategy.&text=A%20strong%20franchise%20system%20helps,and%20reach%20a%20broader%20audience.> accessed 1.06.2025.



creating awareness, and maintaining it often require higher marketing costs. However, it makes more sense to use something that already works instead of starting from scratch, as long as it's done legally and both parties agree on the terms beforehand. If both the franchisor and the franchisee work together, success is almost guaranteed.<sup>5</sup>

The International Franchising Association<sup>6</sup> has been contributing to the development of this institution for decades. The existence and experience of the association once again confirm the aspiration of franchising to go beyond the borders of one state and ensure the maximum increase in the quality and intensity of the provision of goods and services.<sup>7</sup>

Nowadays, franchising agreements are no longer new to Georgian society, but Georgian legal doctrine does not pay much attention to them. In the last few years, only a few articles have been written about the importance of franchising, mostly from an economic perspective, but none have addressed the significance of legal regulation. There is almost no practice of state courts in Georgia regarding franchising agreements, A court case having shaped the contours of new franchise agreements, or a case being recognized as having had a significant role in regulating the franchising environment do not exist, let alone a case that has “created new law” with its decision.<sup>8</sup>

## **1.2 The Jurisdictions Covered**

This paper will focus on a comparative legal analysis of franchising regulations in the United States, Germany, and France, jurisdictions with well-established and structured franchising frameworks, with a short digression on the law of the European Union (EU). These countries were

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<sup>5</sup> Tsertsvadze, Giorgi, “Commentary on the Civil Code of Georgia”, Book III, Contract Law (Private Part), Tbilisi, 2016, Article 607, Box 2, p.1.

<sup>6</sup> The International Franchising Association <https://www.franchise.org>, accessed 09.03.2025.

<sup>7</sup> Mendelsohn, Martin, “The Guide to Franchising”. 7th ed. London: Cassell, 2004, p.5.

<sup>8</sup> Ibid

selected due to their comprehensive franchising laws, well-developed case law, and practical regulatory measures that provide stability and legal clarity for both franchisors and franchisees.

### **1.3 Research and Methodology Issues**

In this thesis, I will use a comparative legal research approach, which involves assessing how different legal systems regulate franchising and identifying functional elements that may be adapted to the Georgian legal context. Comparative legal studies are particularly relevant for legal reform, as they help highlight gaps, assess alternative solutions, and develop best practices.<sup>9</sup>

This research faces several challenges. First, Georgia's civil law system differs from the common law structure of the U.S., making direct legal adaptation difficult. However, by exploiting the freedom of contract principle, U.S. franchise systems are already present in Georgia, and they have impacted Georgian franchise law. Although Germany is not a common law system, its courts do shape the law, and this was also the case with the business format franchise, which originated in the U.S. Consequently, Georgian lawmakers can, indeed, learn from German franchise-related cases, and even enshrine some of the lessons into the Georgian Civil Code. Language barriers can also pose difficulties when analyzing German legal sources.

Lastly, economic and enforcement factors must be considered, as legal reforms alone may not fully address the challenges franchisors and franchisees face in Georgia. Georgian franchise law has unique problems in this jurisdiction, including encroachment and the balance of power between parties. Despite these limitations, the comparative approach will provide valuable insights for improving Georgia's franchising regulations.

### **1.4 Literature review**

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<sup>9</sup> Eberle, Edward J. "The Methodology of Comparative Law," *Roger Williams University Law Review*: Vol. 16: Iss. 1, Article 2, 201, p.72. Available at: [http://docs.rwu.edu/rwu\\_LR/vol16/iss1/2](http://docs.rwu.edu/rwu_LR/vol16/iss1/2).

The existing literature on franchising law provides valuable insights into how different jurisdictions regulate franchise agreements, protect franchisees, and address disputes. However, research specifically focused on Georgian franchising law is limited, making this study an important contribution to the field. Much of the academic work on franchising law highlights the importance of disclosure regulations, fair contractual terms, and balanced dispute resolution mechanisms<sup>10</sup>.

Studies on U.S. franchising law emphasize the role of the FTC Franchise Rule, which mandates full disclosure before contracts are signed<sup>11</sup>. Research on German franchising law discusses how contract law and judicial precedents play a key role in defining franchisor-franchisee relationships.<sup>12</sup> But neither disclosure-based (U.S.) nor litigation-dependent (German) models offer complete solutions. By critically analyzing these systems, this thesis identifies adaptable elements and proposes safeguards that are absent in their original contexts.

While these sources provide valuable comparative insights, there is a lack of research focusing on how Georgia's legal framework can be improved based on international best practices. This thesis will bridge this gap by analyzing Georgia's existing franchising laws, examining U.S., German, and French models key court decisions, and proposing legal reforms inspired by the countries.

### **1.5 The Roadmap to the Thesis**

This thesis will begin by introducing the challenges of franchising law in Georgia, highlighting its insufficient regulation under the Civil Code. The research will analyze, in Chapter One,

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<sup>10</sup> Mendelsohn, Martin, "The Guide to Franchising" 7th ed. London: Cassell, 2004, p.5.

<sup>11</sup> Spencer, Elizabeth Crawford and Edward Elgar Publishing, "The Regulation of Franchising in the New Global Economy" Cheltenham Edward Elgar, 2010, p.2

<sup>12</sup> Tajti Tibor, "Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?", 37 Loy. L.A. Int'l & Comp. L. Rev. 245 (2016), p.259.

Georgian franchising law, identifying gaps and key court decisions that reveal legal uncertainties. A comparative study of U.S. and German franchising regulations will follow in Chapters Two and Three, examining how these countries structure franchise agreements, disclosure requirements, and legal protections. Based on these findings, the thesis will propose specific legal reforms for Georgia, aiming to create a more transparent, more balanced legal framework that supports franchise business growth while ensuring fairness between franchisors and franchisees. The conclusion will summarize key recommendations and suggest areas for further research.

## Chapter 1. The practice and law of franchising in Georgia

### 1.1. The concept and definition of franchising in Georgia

There is no universally recognized single definition of franchising in the world's legal doctrine, but the core elements remain consistent. The franchise project of the International Institute for the Unification of Private Law (UNIDROIT) franchise project can be seen as an expression of a harmonized understanding of franchising, capturing the essential features recognized in comparative legal and business practice.<sup>13</sup> The differences depend on the system, recognition, and practice to formulate the definition of franchising in a country. Even international organizations define franchising in different ways. The International Franchise Association defines franchising as „a method of expanding a business and distributing goods and services through a licensing relationship. In franchising, franchisors (a person or company that grants a license to a third party to conduct business under their brand) not only specify the products and services to be offered by franchisees (a person or company that is granted a license under the trademark and trade name by the franchisor) but also provide them with branding and support.“<sup>14</sup> This could be called a universal explanation of the concept of franchising. According to the definition of the world intellectual property organization, franchising is "a method of business expansion characterized by a franchisor granting a license to a franchisee to operate a business or distribute goods or services under the franchisor's brand and system, in exchange for fees or royalties."<sup>15</sup> The definition reflects the nature of the relationship between the parties. Although franchising is built on a contractual partnership between two independent businesses, the parties are not entirely equal in their relationship. While franchising provides opportunities for business

<sup>13</sup> UNIDROIT. (2002) "Model Franchise Disclosure Law" International Institute for the Unification of Private Law, Rome. <https://www.unidroit.org/instruments/franchising> accessed 21.04.2024.

<sup>14</sup>The International Franchising Association <https://www.franchise.org/franchising-overview/what-is-a-franchise/>, accessed 9.03.2025.

<sup>15</sup> The World Intellectual Property Organization (WIPO) <https://www.wipo.int/portal/en/>, accessed 10.03.2025.

growth and local entrepreneurship, it also creates a relationship of economic and legal dependence where the franchisor's control over the brand must be balanced against the franchisee's entrepreneurial freedom. This is a franchising asymmetry that is also a problem in the Georgian system and will be discussed in Chapters One and Four.

## **1.2. History and development of franchising in Georgia**

In line with the development of entrepreneurial activities in general, the importance of franchising has increased gradually in Georgia as well, primarily due to the increasing pace of goods and services being supplied to meet consumer demand.<sup>16</sup> According to one author, interestingly, relationships similar to franchising existed in the Western parts of contemporary Georgia in earlier centuries and were connected to the tradition of horse stealing, which was allowed only with the permission of the feudal lord who owned the stable. Serfs were required to take their horses to their master's stable and pay a specific fee for this service.<sup>17</sup>

Franchising in its modern classical form surfaced and was introduced in Georgia in the early 1990s as a form of foreign investment.<sup>18</sup> Franchising became known in the Georgian legislative space with the legislative amendments introduced to the Civil Code adopted in 1997.<sup>19</sup> However, its implementation became possible before it was addressed by legislation.<sup>20</sup> I think it is a product of the freedom of contract principle and the “flexibility of the contract law that helps to create new

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<sup>16</sup> Tsertsvadze, Giorgi, “Commentary on the Civil Code of Georgia”, Book III, Contract Law (Private Part), Tbilisi, 2016, Article 607, p.2.

<sup>17</sup> Tutrashvili Shorena, “franchising”, 2010, p.29-30 as cited in Tsertsvadze, Giorgi, “Commentary on the Civil Code of Georgia”, Book III, Contract Law (Private Part), Tbilisi, 2016, Article 607, p.3.

<sup>18</sup> Dvalishvili Mariam, “Franchising as a method of entering the international market and its results”, as mentioned in, Guram Tavartkiladze Tbilisi Teaching University, master's thesis, Tbilisi, 2019, p.12.

<sup>19</sup> Civil Code of Georgia, “საქართველოს სამოქალაქო კოდექსი” <https://matsne.gov.ge/ka/document/view/31702?publication=133>, accessed 15.04.2025.

<sup>20</sup> Chachanidze, Tinatin, “Legal regulation of franchise relations”, Roman Shengelia ed, Bona Kauza, Tbilisi, 2010, p.13.

forms of contracts”<sup>21</sup>. One of the most striking examples of industrial franchising in Georgia is the entry of the global franchising brand “Coca-Cola”. This company has invested in Georgia and employed hundreds of people. The company is considered one of the most significant contributors to the Georgian budget. In addition to Coca-Cola, such international transnational organizations as “McDonald’s”, the chain of stores “Bata” and others operate in Georgia through the franchising system.<sup>22</sup>

Facilitating the development of entrepreneurial activity is one of the main obligations of the state, which is primarily achieved by creating a conducive legislative framework.<sup>23</sup> The inclusion of franchising agreements in the Civil Code of Georgia was an expression of this.<sup>24</sup> Derived from the Civil Code of Georgia, franchising can be defined as a system of using goods, services, or technology, which is based on a joint long-term relationship between the franchisor and the franchisee as independent enterprises.<sup>25</sup> The general regulation of franchising contracts under the Civil Code aligns with current developments in American and European private law. This will ensure that the principle of freedom of contract prevails when regulating long-term relationships.<sup>26</sup> However, the transfer of only a few articles to the German Civil Code, without adapting them to franchising’s unique needs (e.g., disclosure duties, termination safeguards, or imbalance remedies) does not mean regulation of the field, which creates problems in practice. These clauses fail to address essential aspects such as disclosure requirements, dispute resolution, and franchisee

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<sup>21</sup> Larry A. DiMatteo, “Strategic Contracting: Contract Law as a Source of Competitive Advantage”, *Am. Bus. L.J.* vol.47, 2010, p.731.

<sup>22</sup> Dvalishvili Mariam, “Franchising as a method of entering the international market and its results”, as mentioned in, Guram Tavartkiladze Tbilisi Teaching University, master’s thesis, Tbilisi, 2019, p.12.

<sup>23</sup> Chachanidze, Tinatin, “Legal regulation of franchise relations”, Roman Shengelia ed, Bona Kauza, Tbilisi, 2010, p.6.

<sup>24</sup> Modern types of contracts such as “leasing” and “franchising.”

<sup>25</sup> Bakradze Pikria, “Overview of the main features of a franchise agreement”, *Georgian-German Journal of comparative law*, 4/2022, p.9.

<sup>26</sup> Zekoll Joachim, Reimann Mathias, “Introduction to German Law”, 2<sup>nd</sup> edition. Kluwer Law International, 2005, p.184.

protections. This lack of regulatory detail caused legal uncertainties, including pre-contractual transparency and franchisee protections, making it difficult for both franchisors and franchisees to navigate their rights and obligations effectively.

### **1.3. The legal framework governing franchising in Georgia**

Franchising is one of the nominated types of contracts in Georgian law. The Civil Code of Georgia has not been amended since the introduction of the franchise agreement, so, irrespective of the fact that it was passed in 1997, it remains the law in force and thus provides a proper reflection of the perception of franchising in Georgia at the time of writing this thesis.<sup>27</sup> This is mainly because there is no need for amendments in practice. However, specific changes could make it attractive not only to Georgian but also to foreign investors, which would lead to the advancement and economic growth of Georgian businesses. Article 607 of the Civil Code of Georgia defined the concept of the agreement: *“A franchising agreement is a long-term contractual relationship, by which independent enterprises mutually undertake, as necessary, to facilitate the production, sale and provision of services through the fulfillment of specific obligations.”*<sup>28</sup>

The Civil Code of Georgia regulates franchising through a framework that imposes specific obligations for both parties, which causes the asymmetric rights and protections that (primarily) bind franchisees.<sup>29</sup> The Civil Code of Georgia imposes rigorous performance obligations on franchisees while granting franchisors substantial control mechanisms. According to this, franchisees must maintain strict operational compliance (article 609), the “incomplete

<sup>27</sup> Chachanidze, Tinatin, “Legal regulation of franchise relations”, Roman Shengelia ed, Bona Kauza, Tbilisi, 2010, p.15.

<sup>28</sup> Civil Code of Georgia, 26.06.1997, Article 607.

<sup>29</sup> Tajti Tibor, “Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?”, 37 Loy. L.A. Int'l & Comp. L. Rev. 245 (2016), p.248.



contracting”<sup>30</sup> paradox, where franchisees lack autonomy despite nominal independence. Additionally, franchisees must accept financial obligations (Article 609), which are established by the franchisor, as well as extensive confidentiality obligations (Article 610). At the same time, franchisors retain discretion over system modifications (Article 608(2)), which is an expression of “Strategic asymmetry”<sup>31</sup>, control of commercial relationships through designated suppliers, and the ability to impose post-term restrictions (Article 613), where franchisees face 1-year non-compete restrictions. In contrast, franchisors retain expansion rights ("encroachment"), a globally contested imbalance.<sup>32</sup>

While discussing asymmetry, the limited protections for franchisees concerning disclosure requirements need to be mentioned. Namely, while parties must exchange "complete information"(Article 610), the Civil Code lacks specificity on pre-contractual disclosures, unlike the UNIDROIT Model Law’s itemized requirements.<sup>33</sup> Also, franchisees may seek fee reductions for franchisor defaults (article 614), but the burden of proof and reliance on expert determination favor resource-rich franchisors.<sup>34</sup> Lastly, Franchisees may claim compensation if restrictions harm their livelihoods (Art. 613(2)), but the provision is vague (e.g., "appropriate compensation").

Franchising comes in two main forms. The first involves the distribution of products, and the second consists of transferring a complete cycle of business operations, where the difference between the franchisor and the franchisee is practically no longer necessary for the customer. In the latter case, the franchisee is so “integrated” into the system created by the franchisor that his

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<sup>30</sup> Hadfield, Gillian K. “Problematic Relations: Franchising and the Law of Incomplete Contracts.” *Stanford Law Review*, vol. 42, no. 4, 1990, P. 928. *JSTOR*, <https://doi.org/10.2307/1228908>. accessed 20 Apr. 2025.

<sup>31</sup> Tajti Tibor, “Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?”, 37 *Loy. L.A. Int'l & Comp. L. Rev.* 245 (2016), p.245.

<sup>32</sup> *ibid*, p.250.

<sup>33</sup> UNIDROIT. (2002), “Model Franchise Disclosure Law” International Institute for the Unification of Private Law, Rome, <https://www.unidroit.org/instruments/franchising>.

<sup>34</sup> Tsertsvadze, Giorgi, “Commentary on the Civil Code of Georgia”, Book III, Contract Law (Private Part), Tbilisi, 2016, Article 614, Box 2, p.1.

responsibility to the customer is equal to the responsibility of the “brand” and the creator of the system.<sup>35</sup>

The legal nature of a franchise agreement is quite specific. A franchise agreement is characterized by complexity, as it represents a mixture of sales contracts, service contracts, agency relationships, intellectual property law, and competition law regulations.<sup>36</sup> Judicial practice regarding Georgian franchising is quite scarce. Hence, one should be cautious about withdrawing too far-reaching empirically based conclusions. If we search the word franchising on the Georgian Court Case Management System website<sup>37</sup>, we can only see three cases where franchising has no vital role, so there is no case law regarding franchising in Georgia.

Based on this information, we can conclude that Georgian legislation is somewhat has a development issue in public relations, as well as the franchising regulations found in U.S. and European legal systems. However, in the context of a developing market economy, the principle of freedom of contract play an important role. It allows private law subjects to use franchising as a flexible form of entrepreneurial relationship.<sup>38</sup> Accordingly, the franchisor and franchisee, by fulfilling their respective obligations, contribute to the development of production, the sale of goods, and the provision of services.<sup>39</sup> Therefore, regulating these relations is essential to promote the growth of the economics based on franchising and non-standard relations. This means balancing the relationship between the franchisor and the franchisee based on legal and contractual considerations, which will make individuals or companies more willing to invest in established and publicly recognized "names" in the future.

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<sup>35</sup> Mendelsohn Martin, *Franchising Law*, 2nd Edition, 2004, p.7.

<sup>36</sup> Chachanidze, Tinatin, "Legal regulation of franchise relations", Roman Shengelia ed, *Bona Kauza*, Tbilisi, 2010, p.85.

<sup>37</sup> <https://ecd.court.ge/Decision>.

<sup>38</sup> Svanadze Giorgi, "Contractual Law", Giorgi Jugheli (ed.), Tbilisi, 2014, p.102-103. See

<sup>39</sup> Bakradze, Pikria, Overview of the main features of a franchise agreement, *Georgian German Journal of comparative law*, 4/2022, p.8.

#### 1.4. Examples of franchising in Georgia

In Georgia, franchising is considered one of the best ways to attract investment to the local economy.<sup>40</sup> It should be mentioned that franchising in Georgia is mostly developed through foreign brands, such as fast-food restaurants or hotel chains.<sup>41</sup> International transnational organizations such as McDonald's, the Yves Rocher cosmetic brand, and so on operate in Georgia through the franchising system.

A local example of enterprise franchising in Georgia is the beer-producing organization “Kazbegi”<sup>42</sup>, which, thanks to this system, opened dozens of bars and restaurants selling exclusively beer produced by “Kazbegi” under the “Kazbegi” trademark throughout Georgia within a short period, which sell only beer produced by “Kazbegi”. “Kazbegi” has also taken necessary steps in the direction of industrial franchising. Breweries were launched under its license and trademark. In total, hundreds of people were created in the Kazbegi system, which is a massive result for one enterprise, considering the current employment policy in Georgia.<sup>43</sup>

At the end of March 2025, one of the coffee shops based in Tbilisi initiated to open a second franchise spot. “Coffeesta”<sup>44</sup> is the first classic coffee shop chain in Tbilisi, launched in 2015. Today, it operates seven company-owned locations and one franchised outlet. The franchise model allows partners to open their coffee shop under the “Coffeesta” brand, benefiting from a proven operational system. The franchise system is structured around a five-step process,

<sup>40</sup> Jorbenadze Sandro, “Franchising Agreement”, Tbilisi, 2000, p.6.

<sup>41</sup> Tsertsvadze Giorgi, “Commentary on the Civil Code of Georgia”, Book III, Contract Law (Private Part), Tbilisi, 2016, Article 607, p.4.

<sup>42</sup> “ლუდი ყაზბეგი-Kazbegi Beer” <https://www.facebook.com/kazbegibeer> accessed 20.04.2025.

<sup>43</sup> Dvalishvili Mariam, “Franchising as a method of entering the international market and its results”, Guram Tavartkiladze Tbilisi Teaching University, Tbilisi, 2019, master’s thesis p.13.

<sup>44</sup> “Coffeesta” Established in June 2015, Coffeesta Coffee Shop has grown from a local Georgian startup to become one of the nation's fastest-growing coffee chains. As an innovative player in Georgia's coffee retail sector, they have developed multiple service formats to cater to diverse customer needs. <https://www.coffeesta.com> accessed 20.04.2025.

beginning with an application and culminating in the opening of a fully supported and operational coffee shop. The franchise agreement is concluded for a minimum period of five years, requiring an average initial investment of approximately €50,000. Franchisees are obligated to pay a €2,000 initial franchise fee, a 5% monthly royalty fee, and a fixed monthly marketing and monitoring fee. In exchange, they receive brand rights, operational training, marketing support, and continuous monitoring from the franchisor.<sup>45</sup>

To conclude the thoughts as mentioned above, franchising in Georgia has evolved from an unfamiliar concept to a recognized business model primarily driven by foreign investments and international brands. The scarcity of case law further emphasizes the need for a more comprehensive legal approach. Nevertheless, practical examples such as Coca-Cola, Kazbegi, and Coffeesta demonstrate the potential of franchising as a dynamic tool for business development and employment generation in Georgia. Notably, the rise of local initiatives like Coffeesta indicates a growing domestic understanding and application of franchising models.

### **1.5. Main Problems of Georgian Franchise Law**

While franchising is legally recognized in Georgia, the existing legal framework is far from comprehensive. Several key issues make it challenging for both franchisors and franchisees to navigate their rights and obligations effectively. These issues mainly stem from a general lack of detailed regulation, legal imbalances between the parties, and minimal case law.

One of the main concerns is an asymmetry in contractual obligations between franchisors and franchisees. While the freedom of contract principle allows the parties to define their terms, the Civil Code imposes stringent operational, financial, and confidentiality duties on franchisees (e.g., Articles 609–610), without imposing obligations also on the franchisor to provide protections to

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<sup>45</sup> Coffeesta, 'Franchise Offer' (Coffeesta, 2025) <https://www.coffeesta.com/franchise> accessed 8.04.2025.

the franchisees as well. For instance, the franchisor retains broad control over system modifications (Article 608(2)). It can impose post-contractual non-compete clauses (Article 613), creating a form of “strategic asymmetry”<sup>46</sup> that limits the entrepreneurial freedom of franchisees. Mainly, because of the asymmetry, “all risks shifted to franchisees, their hands are tied, and there is no “equivalency of performance.”<sup>47</sup>

Furthermore, another problem we can observe is the lack of specific pre-contractual disclosure requirements, which weakens the franchisee’s position. Article 610 of the Civil Code obliges the exchange of “complete information.” Still, it fails to outline what information must be disclosed, such as financial performance data, legal history, or operational costs. This information is not even mentioned in the commentary on the clause. This stands in contrast with international instruments like the UNIDROIT Model Franchise Law, which provides a detailed list of mandatory disclosures to protect franchisees from entering into unfair agreements without sufficient knowledge.<sup>48</sup>

Legal protections for franchisees are also minimal. Although franchisees can seek remedies for franchisor breaches under general contract law (e.g., fee reduction under Article 614 or compensation under Article 613(2)), the effectiveness of these provisions is limited by their vagueness and the burden of proof, which typically favors better-resourced franchisors. This imbalance is exacerbated by the lack of clear procedural rules for dispute resolution, leaving parties to resolve conflicts through uncertain or protracted litigation processes. The court is obligated to

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<sup>46</sup> Tajti Tibor, “Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?”, 37 Loy. L.A. Int’l & Comp. L. Rev. 245 (2016), p.245.

<sup>47</sup> Decision of the Court of Appeal of Katowice, No. I ACa 636/98; see Kaźmierczyk & Kijowski, *supra* note 4, at 655. As mentioned in Tibor Tajti, “Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?”, 37 Loy. L.A. Int’l & Comp. L. Rev. 245 (2016), p.247.

<sup>48</sup> UNIDROIT. (2002), “Model Franchise Disclosure Law” International Institute for the Unification of Private Law. Rome. <https://www.unidroit.org/instruments/franchising> accessed 21.04.2024.

thoroughly examine the circumstances of the case before deciding.<sup>49</sup> Like in the case of the German Higher Regional Court of Thuringia, which refused to enforce an ICDR arbitral award rendered in the U.S. The arbitration clause, which required proceedings in New York, was deemed to impose a significant disadvantage on the German franchisee. Applying Liechtenstein law by implied choice, the court held the clause invalid due to the procedural imbalance. This shows a growing judicial recognition of inequities in franchising agreements and a willingness to curtail enforcement where franchisees are unfairly burdened.<sup>50</sup>

Another problem is the lack of judicial practice. Franchising is still relatively new in Georgia, and there are barely any court decisions interpreting franchise-related laws.<sup>51</sup> As a result, businesses don't have much guidance on how the rules are applied in real-life situations. This uncertainty can make investors, especially foreign ones, more cautious about entering the Georgian market.

Lastly, the norms governing franchising relationships are complex and closely linked to various institutions or fields of law.<sup>52</sup> But the Georgian Civil Code treats franchising as a simple contract type, without addressing this complexity. This limits the legal system's ability to respond to the specific needs and challenges of franchise relationships.

In short, while Georgia has taken important steps by recognizing franchising as a legal entity, much more needs to be done to develop the sector further. This chapter outlined the history,

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<sup>49</sup> Tsertsvadze Giorgi, "Commentary on the Civil Code of Georgia", Book III, Contract Law (Private Part), Tbilisi, 2016, Article 614, p.3.

<sup>50</sup> Ana Mercedes López Rodríguez, *Lex Mercatoria* (2002) (unpublished Ph.D. dissertation, Univ. of Aarhus) and *Subsidiary Company of Franchiser v. Franchisee*, in 37 YEARBOOK OF COMMERCIAL ARBITRATION 2012, 220, 220 (Kluwer Law Int'l. 2012) as mentioned in Tibor Tajti, "Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?", 37 Loy. L.A. Int'l & Comp. L. Rev. 245 (2016), p.247.

<sup>51</sup> Pikria Bakradze, Overview of the main features of a franchise agreement, Georgian-German Journal of comparative law, 4/2022, p.9.

<sup>52</sup> Chachanidze, Tinatin, "Legal regulation of franchise relations", Roman Shengelia ed, Bona Kauza, Tbilisi, 2010, p.23, as mentioned Tsertsvadze, Giorgi, "Commentary on the Civil Code of Georgia", Book III, Contract Law (Private Part), Tbilisi, 2016, Article 607, Box 2, p.1.

evolution, legal structure, and current challenges of franchising in Georgia. Although legally acknowledged, franchising remains poorly regulated, with asymmetrical obligations, weak disclosure rules, and minimal case law. These gaps show serious barriers to business certainty and growth. Despite its economic potential, franchising in Georgia lacks the necessary legal infrastructure to protect both franchisors and franchisees effectively.

## **Chapter 2 Review of franchise law of the United States with a focus on California: problems and solutions**

### **2.1 History and overview of the franchising system in the US.**

The United States, in my opinion, has the most developed and most tested franchising regulatory systems in the world. Franchise businesses in the U.S. operate under a strict legal framework that includes both federal and state-level regulations. Many U.S. states have enacted specific franchise relationship laws, which regulate aspects such as contract termination, non-renewal, and dispute resolution.<sup>53</sup> Studying U.S. regulations will help determine whether similar protective measures should be introduced in Georgia to create a more transparent and balanced franchising environment.

Franchising in the United States experienced quick growth in the 1960s<sup>54</sup> and is now expanding into new areas.<sup>55</sup> The foundations of modern franchising can be traced back to the Middle Ages, while the Catholic Church established agreements, like franchises, with tax collectors. These collectors kept a percentage of the funds they gathered while remitting the remaining amount to the church.<sup>56</sup> It remains one of the world's largest franchise industries, continuing to grow despite the challenges posed by COVID-19 and economic uncertainties in 2023.<sup>57</sup> In the United States, franchising is governed at the federal and state levels at the same time.<sup>58</sup> At the federal level, it is

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<sup>53</sup>Franchise State-By-State Registration, [https://www.taftlaw.com/resources/franchise-state-by-state-registration/?utm\\_source=chatgpt.com](https://www.taftlaw.com/resources/franchise-state-by-state-registration/?utm_source=chatgpt.com) accessed 10.03.2025.

<sup>54</sup> Imed Eddine Bekhouche, "The Law Relating to Disclosure, Registration & Financial Aspects in Franchise: A Study in Algeria." (2023), p.59.

<sup>55</sup> Paul A. Lester, International Franchising- A Brief Introduction, Vol.3(Number 1) Journal of the Forum Committee on Franchising, Miami, Florida, Summer 1983, p.1.

<sup>56</sup> Sharp, Arthur G. (n.d.) *HISTORY OF FRANCHISING*. <https://www.referenceforbusiness.com/encyclopedia/For-Gol/Franchising.html> Accessed 31.03.2025

<sup>57</sup> 2024 Franchising Economic Outlook, P.2 <https://www.franchise.org/wp-content/uploads/2025/03/2024-Franchising-Economic-Report.pdf> accessed 21.04.2025.

<sup>58</sup> Radwa Elsaman, "Disclosure and Registration Requirements in Franchising: Common Law or Civil Perspective?," Tulsa Law Review 58, no. 2-3, Spring 2023, p.281.



regulated by the FTC Rule, and at the state level, by different states’ “franchise laws, franchise relationship laws, business opportunity laws, and “little FTC acts”.<sup>59</sup>

### 2.2.1. Overview of the Federal Trade Commission Rule

The U.S. system offers valuable insights into franchisee protection mechanisms, contract disclosure requirements, and dispute resolution strategies. To help prevent dishonest franchise sales, the FTC has created a rule that requires franchisors to disclose important information before any sale occurs.<sup>60</sup> The rule was first published in 1978,<sup>61</sup> which was changed and amended in July 2007.<sup>62</sup> It doesn’t control the actual terms of the franchise agreement or how the relationship works day-to-day. Instead, it focuses on giving potential franchisees the facts they need upfront, so they can decide for themselves if the deal is right for them.<sup>63</sup> The strict Franchise Disclosure Document (FDD), a legal document that franchisors provide to future franchisees that contains essential information about operating the franchise,<sup>64</sup> which contains 23 items that the franchisor must disclose, such as the company’s background, the costs involved, any legal trouble the franchisor has been in.<sup>65</sup> This requirement ensures franchisees understand financial risks and contractual

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<sup>59</sup> David J. Kaufmann, How Does the Law Regulate Franchising? <https://msaworldwide.com/finance-and-legal/how-does-the-law-regulate-franchising/#:~:text=At%20the%20federal%20level%2C%20by,and%20%20little%20FTC%20acts>. accessed 10.04.2025.

<sup>60</sup> Keith Kanouse, The FTC Franchise Registry: Its Time Has Come, Franchise Law Journal, 2009, p.17.

<sup>61</sup> 43 FR 59614 (December 21, 1978).

<sup>62</sup> Gerald C. Wells & Dennis E. Wieczorek, “A Road Map to the New FTC Franchise Rule”, Franchise Law Journal, 2007, p.105

<sup>63</sup> Federal trade Commission, Franchise Rule, 16 C.F.R. Part 436 (federal Register Notice), 1999. p.57294 [https://www.ftc.gov/sites/default/files/documents/federal\\_register\\_notices/franchise-rule-16-cfr-part-436/991022franchis.pdf](https://www.ftc.gov/sites/default/files/documents/federal_register_notices/franchise-rule-16-cfr-part-436/991022franchis.pdf) accessed 04.05.2025.

<sup>64</sup> What Is a Franchise Disclosure Document (FDD)? Requirements, [https://www.investopedia.com/terms/f/franchise-disclosure-document.asp#:~:text=The%20franchise%20disclosure%20document%20\(FDD,to%20make%20a%20significant%20investment](https://www.investopedia.com/terms/f/franchise-disclosure-document.asp#:~:text=The%20franchise%20disclosure%20document%20(FDD,to%20make%20a%20significant%20investment). accessed 04.05.2025.

<sup>65</sup> What You Need to Know About Federal Franchise Laws, <https://frannet.com/resources/business-opportunity-2/what-you-need-to-know-about-federal-franchise-laws/#:~:text=The%20Key%20Federal%20Law:%20FTC%20Franchise%20Rule&text=With%20a%20focus%20on%20transparency,practices%20in%20the%20franchising%20world>. accessed 04.05.2025.

obligations.<sup>66</sup> FDD has to be delivered at least 14 days before any contracts are signed or payments are made.<sup>67</sup> This practice is absent from Georgia's legal system.

It's important to understand, though, that the FTC Rule is a disclosure law only. That means the FTC doesn't "approve" any franchise or guarantee its success. The goal is to ensure that all material terms and any critical information that could influence a decision are laid out clearly before any deal is made.<sup>68</sup>

Regarding any wrongdoing and enforcement, if a franchisor leaves out crucial facts, gives misleading information, or lies outright, the prospective franchisee can report it to the FTC. This kind of violation, whether it's a false claim or a significant omission, could lead to legal consequences.<sup>69</sup> It doesn't guarantee that the FTC will always investigate or punish every complaint. In other words, the rule empowers, but it doesn't promise automatic enforcement by the FTC in every situation.<sup>70</sup>

In short, the FTC Franchise Rule doesn't guarantee that a franchise will succeed, but it does ensure that you get the truth upfront. If you're considering buying a franchise, this rule helps to ensure you're not going in blind, which is a significant step toward making a wise business decision.

<sup>66</sup> Marisa Rauchway, Franchise Law101: FAQs [https://www.csglaw.com/newsroom/franchise-law-101-faqs/?utm\\_source=chatgpt.com](https://www.csglaw.com/newsroom/franchise-law-101-faqs/?utm_source=chatgpt.com) accessed 31.03.2025.

<sup>67</sup> Franchise Fundamentals: Taking a deep dive into the Franchise Disclosure Document, <https://www.ftc.gov/business-guidance/blog/2023/05/franchise-fundamentals-taking-deep-dive-franchise-disclosure-document#:~:text=You%20must%20receive%20the%20Franchise,and%20agrees%20to%20consider%20it.> accessed 04.05.2025.

<sup>68</sup> Paul Steinberg & Gerald Lescatre, *Beguiling Heresy: Regulating the Franchise Relationship*, 109 Dick. L. Rev. 105, 2004, p.303, available at: <https://ideas.dickinsonlaw.psu.edu/dlra/vol109/iss1/5>.

<sup>69</sup> What You Need to Know About Federal Franchise Laws, <https://frannet.com/resources/business-opportunity-2/what-you-need-to-know-about-federal-franchise-laws/#:~:text=The%20Key%20Federal%20Law:%20FTC%20Franchise%20Rule&text=With%20a%20focus%20on%20transparency,practices%20in%20the%20franchising%20world.> accessed 04.05.2025.

<sup>70</sup> The FTC will not investigate or take action unless it has a "reason to believe" that a violation of the law has occurred. A Brief Overview of the Federal Trade Commission's Investigative, Law Enforcement, and Rulemaking Authority, May 2021, <https://www.ftc.gov/about-ftc/mission/enforcement-authority#:~:text=IL.1.98>. Accessed 08.06.2025

### 2.2.2. Overview of the Californian regulatory framework

Individual states, including California, have introduced additional laws to regulate franchising more strictly. The California Act of 1970 is considered the first piece of legislation regulating franchising<sup>71</sup>. Unlike the federal Franchise Rule administered by the Federal Trade Commission (FTC), which primarily focuses on disclosure requirements,<sup>72</sup> California's regulatory system adds layers of oversight and enforcement at the state level.<sup>73</sup>

The main statute governing franchising in California is the California Franchise Investment Law (CFIL).<sup>74</sup> This law generally “requires franchisors to register with the California Department of Financial Protection and Innovation (DFPI) before offering and selling franchises in California.”<sup>75</sup> Franchisors must provide prospective franchisees with detailed information, including a FDD at least 14 days before the franchisee enters into a binding agreement or makes a payment.<sup>76</sup> California Franchise Investment Act defines a franchise by three elements: 1) Right to do business under a marketing plan prescribed by the franchisor, 2) Connection to the franchisor's trademark, trade name, or service mark, and 3) Payment of a franchise fee (directly or indirectly) to the franchisor.<sup>77</sup> The law aims to ensure that prospective franchisees have sufficient

<sup>71</sup> Tsertsvadze, Giorgi, Commentary on the Civil Code of Georgia, Book III, Contract Law (Private Part), Tbilisi, 2016, Article 607, p.4.

<sup>72</sup> FTC franchise rule, Cornell Law School, Legal Information Institute, [https://www.law.cornell.edu/wex/ftc\\_franchise\\_rule#:~:text=The%20Federal%20Trade%20Commission%20\(FTC%20\)%20Franchise,the%20relevant%20information%20about%20the%20franchise%20](https://www.law.cornell.edu/wex/ftc_franchise_rule#:~:text=The%20Federal%20Trade%20Commission%20(FTC%20)%20Franchise,the%20relevant%20information%20about%20the%20franchise%20), accessed 05.05.2025.

<sup>73</sup> California AB 5; and Differences Between Franchises and Other Business Arrangements, [https://www.lewittackman.com/california-ab-5-and-differences-between-franchises-and-other-business-arrangements/#:~:text=Franchising%2C%20however%2C%20is%20regulated%20by%20federal%20law,\(DBO\)%20or%20it%20is%20exempt%20from%20registration](https://www.lewittackman.com/california-ab-5-and-differences-between-franchises-and-other-business-arrangements/#:~:text=Franchising%2C%20however%2C%20is%20regulated%20by%20federal%20law,(DBO)%20or%20it%20is%20exempt%20from%20registration), accessed 05.05.2025.

<sup>74</sup> California Corporations Code §§ 31000–31516. <https://dfpi.ca.gov/regulated-industries/franchises/about-the-franchise-investment-law/> accessed 05.05.2025.

<sup>75</sup> About the franchise investment law <https://dfpi.ca.gov/regulated-industries/franchises/about-the-franchise-investment-law/#:~:text=In%201970%2C%20the%20California%20Legislature,franchisee%20making%20a%20purchase%20decision>, accessed 05.05.2025.

<sup>76</sup> California Code, Corporations Code - CORP § 31119.

<sup>77</sup> Matthew J. Kreutzer, “Franchise Definition Under the California Franchise Investment Law: Overview”, Howard & Howard PLLC, with Practical Law Commercial Transactions, 2025, p.4

information “to make an informed decision about whether to invest in a franchise.”<sup>78</sup> It also seeks to protect franchisees from fraudulent or deceptive practices.<sup>79</sup> One of the key features of the CFIL is its registration and renewal requirements. Franchisors must renew their registration annually, and any material changes to the franchise system must be promptly reported. This state system may provide more protection to franchisees than the FTC Rule, particularly through its enforcement tools and merit review process.<sup>80</sup>

Alongside the CFIL, California also enforces the California Franchise Relations Act (CFRA).<sup>81</sup> This makes the California franchise law system more franchisee-protective because the CFRA is a state law designed to make franchise relationships fairer and more balanced. It’s designed to protect the rights of people who invest in a franchise and ensure they’re treated fairly by the companies they partner with. The law covers a range of essential topics, like what happens if a franchisor doesn’t want to renew a contract, where legal disputes should be handled, how and when a franchise can be ended, and whether a franchisee can sell or transfer their business to someone else. It also deals with things like forced arbitration clauses and whether the franchisor must buy back unsold inventory when the franchise ends.<sup>82</sup>

In conclusion, California’s franchising regulatory framework exceeds the federal standard. By combining strong disclosure rules with relationship protections, it strikes a thoughtful balance

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<sup>78</sup> Franchisor vs. Franchisee: What’s the Difference? <https://www.premiumservicebrands.com/about-us/our-blog/2023/april/franchisor-vs-franchisee-what-s-the-difference-/> accessed 08.06.2026

<sup>79</sup> Kevin A. Adams, PRIVATE RIGHT OF ACTION UNDER THE CALIFORNIA FRANCHISE INVESTMENT LAW, 2022, [https://mortensontaggart.com/private-right-of-action-under-the-california-franchise-investment-law/#:~:text=The%20California%20Franchise%20Investment%20Law%20\(“CFIL”\)%20governs%20the,the%20CFIL%20can%20be%20complicated.](https://mortensontaggart.com/private-right-of-action-under-the-california-franchise-investment-law/#:~:text=The%20California%20Franchise%20Investment%20Law%20(“CFIL”)%20governs%20the,the%20CFIL%20can%20be%20complicated.) accessed 10.04.2025.

<sup>80</sup> Kendal Tyre, Conducting an audit of international franchise operations, 2025. <https://www.nixonpeabody.com/insights/alerts/2025/05/02/conducting-an-audit-of-international-franchise-operations> accessed 05.05.2025.

<sup>81</sup> Business and Professions Code §§ 20000–20043, <https://dfpi.ca.gov/rules-enforcement/laws-and-regulations/regulations-and-legislation-franchise-investment-law/california-franchise-relations-act/> accessed 05.05.2025.

<sup>82</sup> Overview of The California Franchise Relations Act (CFRA), 2024, <https://www.fortmanlaw.com/overview-of-the-california-franchise-relations-act-cfra/> accessed 05.05.2025.

between holding franchisors accountable and protecting franchisees. While the legal and economic contexts differ, California's approach could offer valuable lessons for Georgia as it seeks to enhance its own franchising environment. This potential will be explored further in the following sections.

### **2.2.3. Resolution of Gaps**

In any franchise relationship, legal and operational "gaps" are almost inevitable. These gaps refer to situations where the franchise agreement is silent, unclear, or insufficient in addressing specific rights, duties, or dispute mechanisms. Addressing and resolving these gaps effectively is essential to maintaining a fair and functional relationship between franchisors and franchisees.

#### **2.2.3.1. Disclosure: Meaning, Strengths and Weaknesses**

As I mentioned above, disclosure lies at the heart of both the FTC Franchise Rule and California's Franchise Investment Law, where the FDD outlines the main details that help the franchisee make an effective decision. The strength here is that it allows franchisees to make smarter choices and stops franchisors from hiding important details or misleading them.<sup>83</sup> However, there are weaknesses as well. Just because a franchisor discloses everything, it doesn't mean the business will succeed or that the deal is fair. Some franchisors might still take advantage of inexperienced buyers and hide risks with complex legal jargon. Plus, the FTC Rule only requires disclosure. It doesn't verify whether the franchise opportunity is viable, beneficial, or fair, so its ability to protect franchisees is limited.

One of the clearest examples of weaknesses in the franchise disclosure system is the case of *FTC v Burgerim*<sup>84</sup>, a fast-casual franchisor that sold over 1,500 franchises in the U.S. between

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<sup>83</sup> Radwa Elsaman, "Franchising Law in the United States between Theory and Practice: Heads up for Foreign Investors," *Touro Law Review* 39, no. 1, 2023, p.46.

<sup>84</sup> *Federal Trade Commission v Burgerim Group USA, Inc*, No 2:22-cv-00636 (2023).

2016 and 2019. The company heavily promoted its concept as a low-risk, “business-in-a-box”.<sup>85</sup> Burgerim targeted first-time entrepreneurs and military veterans, often making verbal promises of support and guaranteed refunds, while failing to provide the required FDD in many cases. This constitutes a direct breach of the FTC Franchise Rule, which requires the pre-sale disclosure of material terms and conditions of the franchise agreement. When many franchisees were unable to open their locations due to excessive costs and a lack of support, refund promises went unfulfilled.

FTC initiated a rare enforcement action against Burgerim in 2022 which was the first of its kind in over a decade that was alleging serious violations of both the Franchise Rule and the FTC Act.<sup>86</sup> The court later entered a default judgment, ordering nearly \$49 million in penalties and redress for affected franchisees. The case is a reminder that disclosure alone is not enough to protect franchisees. While the legal framework may require franchisors to share important information, it cannot prevent aggressive marketing tactics or fraudulent sales offers, when enforcement is delayed or weak. The case, therefore, reveals a critical gap in the franchising system and highlights the need for more robust oversight and faster intervention.

### 2.2.3.2. Encroachment

In the Oxford Dictionary, encroachment is defined as an intrusion on a person's territory, rights, etc.<sup>87</sup> Encroachment in franchising happens when someone starts doing business in a way that cuts into an existing franchisee's area or customer base. It is usually the franchisor or another

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<sup>85</sup>“Business-in-a-box” offers entrepreneurs a ready-made model with built-in support like marketing, branding, and legal services, often at a lower startup cost than traditional franchises—mainly because it avoids real estate expenses and uses technology. However, it typically has lower resale value compared to traditional franchises. <https://delawaresbdc.org/business-in-a-box/#:~:text=In%20an%20era%20of%20an,franchise%20could%20command%20when%20sold.> accessed 14.05.2025.

<sup>86</sup> Foley & Lardner LLP, FTC Initiates Rare Enforcement Action Against Burgerim Franchisor, 3 February 2022 <https://www.foley.com/insights/publications/2022/02/ftc-initiates-rare-enforcement-action-burgerim/> accessed 14.05.2025.

<sup>87</sup><https://www.oxfordreference.com/display/10.1093/oi/authority.20110803095750823#:~:text=N.,appear%20part%20of%20one's%20own.> accessed 08.05.2025.

franchisee. This could mean opening a new location nearby, selling products in the franchisee's territory, or even selling online to the same customers.<sup>88</sup> As a result, the original franchisee may lose sales and earn less money. If the contract doesn't directly address this kind of situation, it can be challenging for franchisees to establish a strong legal case, highlighting the limitations of protections in this area.<sup>89</sup> Often, franchise contracts don't clearly say whether this is allowed or not, leaving a legal gray area. In California, courts sometimes intervene by applying a general rule that both parties to a contract should act fairly and in good faith, especially if the franchisee was led to believe their territory would be protected. A clear contrast in judicial approaches to franchise encroachment appears in *Scheck v. Burger King Corporation*,<sup>90</sup> where the court upheld the franchisor's right to open nearby locations due to the absence of an exclusivity clause, emphasizing a "strict reading" of contract terms. In contrast, *Postal Instant Press, Inc. v. Sealy*<sup>91</sup>, reflects the California courts' willingness to enforce the implied covenant of good faith and fair dealing, thereby protecting franchisees' reasonable expectations, even when not expressly stated in the agreement. This difference illustrates how jurisdiction impacts franchisee protection in encroachment disputes.

#### **2.2.3.3. Adequate Protection of Franchisors**

Although franchise laws often focus on protecting franchisees, especially in California, the law also ensures that franchisors are protected. Franchisors have important rights, including maintaining brand consistency, enforcing quality standards, and terminating agreements with franchisees who fail to perform or violate the rules. California law respects those rights but also

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<sup>88</sup> Rust I. Jefferson, "Regulating Franchise Encroachment: An Analysis of Current and Proposed Legislative Solutions," *Oklahoma City University Law Review* 19, no. 3, Fall 1994, p.490.

<sup>89</sup> Robert W. Emerson, "Franchise Contracts and Territoriality: A French Comparison", *Entrepreneurial Business Law Journal*, vol. 3, no. 2, 2009, p 353.

<sup>90</sup> *Scheck v. Burger King Corp.*, No. 89-1281-Civ., 756 F. Supp. 543 (S.D. Fla. 1991).

<sup>91</sup> *Postal Instant Press, Inc. v. Sealy*, No. B08112, 43 Cal. App. 4th 1704 (1996).

requires franchisors to follow fair procedures. For example, they must provide “proper notice and an opportunity for the franchisee to rectify the problem before terminating the agreement”<sup>92</sup>. This fair and balanced approach helps close legal gaps by ensuring franchisors have control over their brand but can’t act unfairly or without proper notice.<sup>93</sup> For instance, courts have consistently upheld this balanced approach in *Thompson v. 10,000 RV Sales, Inc.*<sup>94</sup>, where the court acknowledged the franchisor’s right to terminate for cause but highlighted the importance of following fair procedures. Similarly, in *Gentis v. Safeguard Business Systems, Inc.*<sup>95</sup> The court affirmed that a franchisor may act to protect its brand reputation, so long as such action is executed in good faith and consistent with statutory obligations. These cases illustrate that California franchise law does not restrict franchisors, but it provides a framework within which franchisors can operate confidently while ensuring that franchisees are not subject to unfair treatment. This dual protection helps to avoid potential legal gaps and promotes stability within franchising relationships.

#### 2.2.3.4. Arbitration of Franchise Disputes

Arbitration is often used to resolve disputes, and many agreements include arbitration clauses. Franchising is not an exception. Sometimes, the rules in franchise agreements about resolving disputes can unfairly favor the franchisor<sup>96</sup> mostly when they require the franchisee to

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<sup>92</sup>Can a Franchisor Terminate a Franchise Agreement? Examining Key Factors. <https://www.gaffneyzoppi.com/blog/can-a-franchisor-terminate-a-franchise-agreement-examining-key-factors> accessed 08.06.2025

<sup>93</sup> California Business and Professions Code § 20020 (2024).

<sup>94</sup> *Thompson v. 10,000 RV Sales, Inc.*, No. D043908, 130 Cal. App. 4th 950 (2005).

<sup>95</sup> *Gentis v. Safeguard Business Systems, Inc.* No. B110351, 60 Cal. App. 4th 1294 (1998).

<sup>96</sup> Arbitration Has Pros Over Litigation, but Watch for Unfair Provisions, 2024 [https://www.franchisetimes.com/franchise\\_insights/arbitration-has-pros-over-litigation-but-watch-for-unfair-provisions/article\\_0271e412-1459-11ef-b511-3313492e51c8.html#:~:text=Arbitration%20clauses%20tell%20franchisees%20how,effective%20than%20a%20traditional%20lawsuit.](https://www.franchisetimes.com/franchise_insights/arbitration-has-pros-over-litigation-but-watch-for-unfair-provisions/article_0271e412-1459-11ef-b511-3313492e51c8.html#:~:text=Arbitration%20clauses%20tell%20franchisees%20how,effective%20than%20a%20traditional%20lawsuit.) accessed 08.05.2025.



handle arbitration in a faraway location. This can be expensive and difficult for the franchisee.<sup>97</sup> In some cases, California courts have stepped in and struck down these kinds of terms when they put too much of a burden on the franchisee. While arbitration can be a helpful way to settle disagreements quickly and privately, it only works well when both sides have a fair shot at presenting their case. In *Nagrampa v. MailCoups, Inc.*<sup>98</sup>, the Ninth Circuit applying California law annulled a forum selection clause that unfairly burdened the franchisee. Similarly, in *Bolter v. Superior Court*<sup>99</sup>, the court refused to enforce a clause that imposed disproportionate costs and lacked mutuality. These decisions, grounded in California's unconscionability doctrine as articulated in *Armendariz v. Foundation Health*<sup>100</sup>, underlined that arbitration only serves its intended purpose when both parties have a genuine, balanced opportunity to be heard.

The U.S. approach, particularly California's franchise laws, demonstrates a mature legal framework that addresses power imbalances through robust disclosure obligations, statutory protections, and judicial interpretations grounded in good faith. While federal regulation focuses on transparency via the FTC Franchise Rule, California supplements this with concrete rules on termination, arbitration, and territorial encroachment. Similar developments are also visible in Germany, where courts have taken an active role in safeguarding franchisee interests through general contract principles such as good faith and culpa in contrahendo.<sup>101</sup> A detailed discussion of these German cases and their implications for Georgia is presented in Chapter 3.

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<sup>97</sup> Ben Hanuka, The ins and outs of franchise arbitration: what parties to a franchise arbitration agreement need to know, <https://www.lawworks.ca/franchise-disputes/franchise-arbitration-agreement-guide/#:~:text=In%20these%20circumstances%2C%20it%20is,drafted%20to%20favour%20the%20franchisor>, accessed 08.05.2025.

<sup>98</sup> *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257 (9th Cir. 2006).

<sup>99</sup> *Bolter v. Superior Court*, 87 Cal. App. 4th 900 (2001).

<sup>100</sup> *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83 (2000).

<sup>101</sup> See section 3.2.1 *infra*.

The chapter concludes that the U.S. model offers Georgia a practical blueprint, particularly in adopting mandatory pre-contractual disclosure and enforcing equitable remedies that could significantly enhance franchisee protection in an emerging market context.

## Chapter 3: Franchise Regulation in Europe

### 3.1. European Union Franchise Law

The European Union does not have a harmonized legal framework specifically governing franchising. Instead, franchise relationships are regulated through a combination of EU-wide rules and national laws of Member States.<sup>102</sup> The main EU legal instrument affecting franchising is the Vertical Block Exemption Regulation (VBER), currently Regulation (EU) 2022/720<sup>103</sup>, which permits certain restrictions in vertical agreements<sup>104</sup>, including franchise arrangements, provided market share thresholds are respected.<sup>105</sup> However, it is essential to note that the VBER is part of the EU's broader competition (antitrust) law, which was designed to preserve market competition, rather than specifically to regulate franchising.<sup>106</sup> In other words, unlike the United States, the EU has no sector-specific franchise law. Franchising in the EU remains underdeveloped compared to the USA despite its €215 billion annual turnover.<sup>107</sup> This is partly due to the fragmented and inconsistent regulatory approach across Member States, which creates trade barriers and legal uncertainty in cross-border franchise relations.<sup>108</sup>

The most crucial organization in Europe connected to franchising is the European Franchise Federation (EFF), which was founded in 1994 and promotes a business model of franchising.<sup>109</sup>

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<sup>102</sup> Franchising in the European Union, <https://www.lexology.com/library/detail.aspx?g=4b8f6671-9048-4043-9c68-f6348a55bd9d> accessed 18.05.2025.

<sup>103</sup> Commission Regulation (EU) 2022/720 of 10 May 2022.

<sup>104</sup> Vertical agreements are contracts between companies operating at different levels within a supply chain, such as a manufacturer and a retailer. Examples of vertical agreements include exclusive distribution agreements, franchise agreements, and technology transfer agreements.

<sup>105</sup> Dr Heinrich Kühnert, M.Jur., Dr Veit Öhlberger, M.Jur., New competition law rules for distribution agreements - the new Vertical Block Exemption Regulation <https://www.dorda.at/en/news/new-competition-law-rules-distribution-agreements-new-vertical-block-exemption-regulation#:~:text=Like%20its%20predecessors%2C%20the%20VBER,the%20VBER%20also%20remains%20unchanged.> accessed 18.05.2025.

<sup>106</sup> EU Competition Law <https://www.lexology.com/library/detail.aspx?g=3e087fcb-ed6d-4c34-8c6d-0aa7c7f88957>, accessed: 03.06.2025

<sup>107</sup> Philip Mark Abell, "The Regulation of Franchising in the European Union", Queen Mary, University of London, PhD, 04.07.2011, p.12.

<sup>108</sup> *ibid*, p.85.

<sup>109</sup> European Franchise Federation <https://eff-franchise.com>.

EFF issued the European Code of Ethics for Franchising to promote ethical standards in franchising, including fair dealing, transparency, and dispute resolution. The code encourages franchisors to act reasonably and disclose key information while ensuring the franchise system is tested and viable.<sup>110</sup>

In addition to this, UNIDROIT adopted a Model Franchise Disclosure Law on 25 September 2002,<sup>111</sup>. This Model Law focuses on pre-contractual disclosure obligations. It does not regulate the ongoing contractual relationship or termination. The decision to limit its scope was based on the complexity and variability of franchise relationships across sectors and systems. However, it was agreed that requiring franchisors to disclose certain key information before contract formation was both feasible and essential. The Model Law applies to all types of franchise agreements, including unit, master, and development franchises, as well as those operating domestically and internationally. Disclosure is required only from franchisors, based on the assumption that franchisees need more protection due to their generally weaker bargaining position and less access to legal resources.<sup>112</sup>

Furthermore, international principles are shaped by the UNIDROIT Guide to International Master Franchise Arrangements (2007).<sup>113</sup> This guide provides best practice recommendations for cross-border franchising, covering disclosure, intellectual property, territorial rights, dispute resolution, and termination. Although not legally binding, it helps encourage more consistent franchise practices around the world and within the EU.

The two most influential models in the EU regarding franchising are Germany and France with their law applicable and case studies and will be discussed in the chapter.

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<sup>110</sup> European Code of Ethics for Franchising, <https://eff-franchise.com/code-of-ethics/> accessed 18.05.2025.

<sup>111</sup> UNIDROIT, Model Franchise Disclosure Law, 2002.

<sup>112</sup> UNIDROIT, Guide to International Master Franchise Arrangements, Second Edition, Rome, 2007. P.304.

<sup>113</sup> *ibid*

### 3.2. German Franchise Law

Germany doesn't have a specific franchise law and not even a legal definition of a franchise. Instead, franchising is governed by general principles like the German Civil Law Code, consumer protection, competition, antitrust law, and the German Trade Code.<sup>114</sup>

The involvement of franchising in Europe began with a well-known case: *Pronuptia de Paris*<sup>115</sup>, which was brought before the European Court of Justice (ECJ) by a German court. The case dealt with whether certain franchise terms, like the requirement for a franchisee to pay overdue fees, were compatible with EU competition rules (specifically Article 85 of the EEC Treaty).<sup>116</sup> In its decision, the Court made some important general points. It recognized that franchisors should be allowed to protect key elements of their business like their brand identity and know-how, but only with clauses that are truly necessary for that purpose. On the other hand, it said that certain restrictions, like controlling the prices a franchisee can charge, were not acceptable.<sup>117</sup> After this landmark ruling, the European Commission followed up with five decisions<sup>118</sup> on franchise cases and introduced the Franchise Block Exemption Regulation in 1988 (Regulation 4087/88)<sup>119</sup> specifically for franchise agreements. That regulation stayed in effect until May 2000,

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<sup>114</sup> Marco Hero, Franchise Laws and Regulations Report 2025 Germany, <https://iclg.com/practice-areas/franchise-laws-and-regulations/germany> accessed 18.05.2025.

<sup>115</sup> *Pronuptia de Paris GmbH v Pronuptia de Paris Irmgard Schillgallis*, Case 161/84 of 28 January 1986.

<sup>116</sup> UNIDROIT, Guide to International Master Franchise Arrangements, Second Edition, Rome, 2007. p.301.

<sup>117</sup> *ibid*, p.302.

<sup>118</sup> Yves Rocher, Decision 87/14/EEC of 17 December 1986; *Pronuptia* Decision 87/17/EEC, of 17 December 1986 ; Computerland, Decision 87/407, of 13 July 1987; ServiceMaster, Decision 88/604 of 20 August 1988 and Charles Jourdan, Decision 89/94/EEC of 2 December 1988.

<sup>119</sup> The Franchising Block Exemption Regulation classified different types of franchise agreements and clarified which competition restrictions were allowed, which were allowed under conditions, and which were not exempted at all. It also introduced a procedure for opposing exemptions.

when it was replaced by a broader Vertical Restraints Block Exemption Regulation<sup>120</sup> that expired on May 31, 2022 and was replaced by the new VBER (EU) 2022/720).<sup>121</sup>

By the above information, we can say that Germany was the country where significant case decisions were made regarding the franchising in EU. What distinguishes German law from the US one is that there is no franchise-specific disclosure nor registration regulation here, but German Civil Code (BGB) article 311 applies which regulates the general contractual negotiation led to a precontractual relationship.<sup>122</sup> Also, this duty arises from Section 242 BGB (good faith) and the principle of “culpa in contrahendo.”<sup>123</sup>

### 3.2.1. Important German Franchise Case Law

Besides the old above-mentioned German court cases, there are a few interesting decisions regarding franchise agreements where we can see that recent German case law continues to develop the view of pre-contractual disclosure and fair dealing in franchise relationships. One important decision is the ruling by the Munich Higher Regional Court, which held that promotional materials and digital communications containing income promises can create liability if they mislead franchisees. Even without formal guarantees, such representations may trigger pre-contractual duties under German law.<sup>124</sup> But here comes the interesting point also from the court’s decision. The court clarified that while the franchisor must give the franchisee accurate and complete information about the franchise system’s profitability, they aren’t required to create

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<sup>120</sup> Regulation No. 330/2010, known as the Vertical Block Exemption Regulation (VBER), was introduced by the EU Commission in 2010 alongside the Vertical Guidelines. It clarified which practices were allowed under Article 101 TFEU and offered a “safe harbour” for certain vertical agreements—such as exclusive, selective distribution, and franchising—between businesses operating at different levels of the supply chain.

<sup>121</sup> UNIDROIT, Guide to International Master Franchise Arrangements, Second Edition, Rome, 2007. p.301-302.

<sup>122</sup> Marco Hero, Franchise Laws and Regulations Report 2025 Germany, <https://iclg.com/practice-areas/franchise-laws-and-regulations/germany> accessed 19.05.2025

<sup>123</sup> legal concept in civil law countries where a party can be held liable for damages resulting from breaches of duties during the negotiation phase of a contract, even before a formal agreement is reached.

<sup>124</sup> OLG München, 23.06.2021-7 U 6141/19.

detailed profit forecasts or cover the cost of such calculations. The franchisor's role is not that of a business consultant. They don't have to advise the franchisee on the general risks of running a business or provide in-depth financial planning support.<sup>125</sup>

Also, a notable case involved a fitness studio franchise where the franchisee engaged in unfair commercial practices without the franchisor's knowledge.<sup>126</sup> The court held the franchisor liable alongside the franchisee, highlighting the necessity for franchisors to ensure compliance with fair competition laws within their networks.<sup>127</sup>

The German court also found it important to decide the duration of a franchise agreement. This approach is interesting because it shows how this will affect both the franchisor and franchisee. The court explained that having a reasonable notice period and a fixed contract term matters not just for the franchisor, but also for the franchisee. For the franchisor, a sudden termination by the franchisee can be problematic because it's hard to find someone new who can immediately make use of the franchisor's know-how. At the same time, the franchisee also benefits from a longer-term contract, since they usually invest a lot upfront, like paying taxes and startup costs, and need time to recover those investments.<sup>128</sup>

### 3.3. French Franchise Law

France was the first European country to introduce legislation related to franchising. On 31 December 1989,<sup>129</sup> it adopted Loi Doubin, Law No. 89-1008, now codified in articles L.330-1 and R.330-3 of the French Commercial Code<sup>130</sup>, aimed at supporting the growth of commercial

<sup>125</sup> OLG Düsseldorf, 5.10.2013 - I-22 U 62/13.

<sup>126</sup> Franchise Law, "Current challenges in franchise law in 2024", [https://www.noerr.com/en/insights/franchise-law?utm\\_source=chatgpt.com](https://www.noerr.com/en/insights/franchise-law?utm_source=chatgpt.com) accessed 18.05.2025.

<sup>127</sup> Augsburg Regional Court (judgment of 6 October 2023 – 81 O 1161/23).

<sup>128</sup> OLG Frankfurt, 08.10.2014-4 U 41/14.

<sup>129</sup> <https://www.unidroit.org/english/guides/2007franchising/country/france.pdf> accessed 22.05.2025.

<sup>130</sup> Franchise laws and regulations France, 2024, <https://iclg.com/practice-areas/franchise-laws-and-regulations/france> accessed 22.05.2025.

businesses and improving their economic, legal, and social conditions. While not exclusively focused on franchising, the law's first article is directly applicable to franchise relationships. It primarily establishes disclosure requirements, with further details provided by Government Decree No. 91-337, issued on April 4, 1991.<sup>131</sup>

Under French law, there is no statutory definition of a franchise. Instead, the concept has been developed through court decisions and legal scholarship. A relationship is generally recognized as a franchise agreement when it includes two key elements: 1) the right to use a registered trademark, and 2) the transfer of know-how. Even if the parties do not explicitly label their contract as a franchise, any agreement containing these components may still be considered a franchise. This classification also implies that the franchisor provides ongoing support to the franchisee to ensure the business's profitability.<sup>132</sup>

What differentiates France from Germany is that French courts generally mention that a franchisor thoroughly tests and validates its business concept before offering it as a franchise. This means the franchisor should be able to demonstrate that the concept has been successfully operated through company-owned outlets for at least two years and that these operations have proven to be profitable.<sup>133</sup> Connected to this, there is an interesting decision. While franchisors aren't expected to guarantee perfect accuracy in financial predictions, they must use reliable methods, such as market research and economic analysis, to support their projections. In this case, Theraform's predictions were overly optimistic and failed to properly consider local market conditions, which the court viewed as a significant flaw. Because of this, the franchise agreement was legally ended

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<sup>131</sup> <https://www.unidroit.org/english/guides/2007franchising/country/france.pdf> accessed 22.05.2025.

<sup>132</sup> Franchise laws and regulations France, 2024, <https://iclg.com/practice-areas/franchise-laws-and-regulations/france> accessed 22.05.2025

<sup>133</sup> *ibid*



due to the franchisor's mistake, and they were ordered to pay back part of the initial fee and cover the franchisee's losses.<sup>134</sup>

### 3.3.1. French Franchise Case Law

There are some important decisions related to franchising in France. Regarding the pre-contractual disclosure, in the decision of the Court of Appeal of Versailles, the court annulled a franchise agreement because the consent was vitiated. The franchisee had entered the contract relying on misleading and overly optimistic profitability forecasts provided by the franchisor. The court held that the franchisor failed in its pre-contractual duty of sincere and accurate disclosure, especially regarding the economic performance of the franchise model. As a result, the franchisor was ordered to reimburse fees and pay damages. This case reinforces the importance of transparency and fair dealing in French franchise law.<sup>135</sup>

The court analyzed an interesting decision regarding asymmetry in franchise agreements. The Subway ruling by the Paris Commercial Court<sup>136</sup> was a landmark decision, as it was among the first to rigorously enforce the principle of "significant imbalance" in franchise agreements. The court examined provisions that disproportionately benefited the franchisor, including mandatory foreign law and arbitration, one-sided termination rights, and contract terms violating statutory limits. It concluded that these created an unfair advantage. By striking down these clauses and issuing a fine, the court made it clear that franchise agreements must maintain fair power dynamics and comply with the requirements of good faith and equitable treatment under French commercial law. This decision reinforced the growing scrutiny of franchisor practices in France, ensuring franchisees are protected from overly oppressive contract terms. While the court didn't explicitly

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<sup>134</sup> Court of Appeal of Orléans, 26.10.2006, N 05/03269.

<sup>135</sup> Court of Appeal of Versailles, 07.06.2007, N 06/01898.

<sup>136</sup> Decision of the Paris Commercial Court, 13.10.2020, N:RG 2017005123.

call asymmetry a built-in feature of franchising, its reasoning clearly showed an understanding that some imbalance is typical. Yet, it must be kept in check when it crosses the line of fairness or violates legal boundaries.

European franchise regulation, though fragmented across jurisdictions, reveals a commitment to contractual fairness through disclosure norms and judicial doctrines such as culpa in contrahendo and abuse of dominance. Germany's reliance on general contract law and France's proactive Loi Doubin framework both offer important lessons. The chapter concludes that Georgia can benefit from the European approach by integrating civil law principles that address pre-contractual good faith, asymmetry in bargaining power, and the necessity of clear statutory disclosure rules, without requiring a fully unified franchise code.

## **Chapter 4: Problems of Georgian franchising law and Recommendations from the US and EU perspective**

One of the Georgian authors who worked on the franchising law concept mentioned that "they are so general in nature that they do not provide a complete picture of the purpose, specific nature, and legal mechanism of application of this institution."<sup>137</sup> To start from the very first article of the Civil Code of Georgia regarding franchising, at first reading, one might get the impression that we are dealing with an agreement by which two parties agree to produce goods or provide services jointly. However, according to Article 607 of the Civil Code of Georgia, the actual content of this article is unclear, unless defined in the franchising agreement of international organizations.

### **4.1. Asymmetry of parties' obligations**

The following articles deal with the obligations of the franchisor and franchisee during the agreement, where the asymmetry comes, which creates problems in both practice and theory.<sup>138</sup> Article 609 imposes broad performance and purchase obligations on franchisees without mutual responsibility by franchisors. Franchisors can modify systems unilaterally<sup>139</sup>, imposing duties on suppliers and imposing a non-compete clause after termination of the contract.<sup>140</sup> This legal imbalance disproportionately burdens the franchisee while consolidating power with the franchisor. However, there is a different provision regarding the importance and existence of franchise asymmetry. The business sector often claims that asymmetry is essential for safeguarding intellectual property rights effectively and serves as a cornerstone of the franchise system's success, even though the level of asymmetry varies significantly across different franchises. Legal

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<sup>137</sup> J.Khetsuriani, franchising, Civil code of Georgia comments, book 4, Part 1, publisher "law", Tbilisi 2001, P. 202, as mentioned in Chachanidze, Tinatin, "Legal regulation of franchise relations", Roman Shengelia ed, Bona Kauza, Tbilisi, 2010, p.28.

<sup>138</sup> Tibor Tajti, "Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?", 37 Loy. L.A. Int'l & Comp. L. Rev. 245 (2016), p.248.

<sup>139</sup> Civil Code of Georgia, "საქართველოს სამოქალაქო კოდექსი", article 608(2) <https://matsne.gov.ge/ka/document/view/31702?publication=133>, accessed 23.05.2025.

<sup>140</sup> Ibid, Article 613.

experts, particularly in Europe more than in the U.S., are generally more cautious about defining asymmetry's significance or assigning it a fixed value. This hesitation may stem largely from the ongoing debate between monist and pluralist contract theories.<sup>141</sup>

There is no agreement whether both parties are equal. Franchising is not an exception, but the question is whether it is necessary to have the asymmetry or not. In Professor Tajti's article, he mentions that "the existence and the important role asymmetry plays in the context of the franchise should go uncontested."<sup>142</sup> The main reason for this is to protect the franchisor's intellectual property and brand. However, I believe asymmetry becomes problematic when it remains unchecked, allowing one party to modify the terms of the relationship unilaterally, or when it prevents the weaker party (typically the franchisee) from protecting its investments. The landmark decision of the Court of Appeal of Katowice<sup>143</sup> offers valuable insights into how legal systems can respond to the inherent asymmetry within franchise relationships.<sup>144</sup> The ruling, which held a franchisor liable for breaching pre-contractual duties and failing to deliver promised support, reflects a robust judicial approach to balancing power disparities in franchise law. At the same time, we can say that the U.S. approach manages asymmetry through informed consent, not by neutralizing the franchisor's control.

In Georgian franchise law, we can see that Franchisees have strict operational and financial duties.<sup>145</sup> Parties have no right to dissolve the contract before the one year required for dissolution, which can harm the franchisee if the franchisor doesn't disclose all the necessary information and

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<sup>141</sup> Tibor Tajti, "Franchise and Contract Asymmetry: A Common Trans-Atlantic Agenda?", 37 *Loy. L.A. Int'l & Comp. L. Rev.* 245 (2016), P.249.

<sup>142</sup> *ibid*

<sup>143</sup> Decision of the Court of Appeal of Katowice, 04.03.1998, No. I ACa 636/98.

<sup>144</sup> See section 3.2.1 *supra*.

<sup>145</sup> Civil Code of Georgia, Article 609.

harm the franchisee that way.<sup>146</sup> On the other hand, Franchisors need to protect their brand name and prestige on the market.

From Georgia's point of view and perspective and additionally, with the concept of franchising, I think that rather than eliminating asymmetry, which would dismantle franchising itself, Georgia should regulate it to ensure fairness and good faith by balancing<sup>147</sup> the rights of both parties. This would preserve the efficiency of franchising while offering franchisees meaningful legal protection.

#### **4.2. Lack of pre-contractual disclosure requirements**

Unlike the FTC Franchise Rule in the US or the Loi Doubin in France, the Civil Code of Georgia does not mandate structured pre-contractual disclosure. Article 610's unclear requirement for sharing information does not specify financial performance, litigation history, or system sustainability. It focuses more on confidentiality. This puts franchisees at risk of entering into contracts with unequal bargaining power and insufficient information, which can lead to potential problems.

For this reason, Georgia should learn from the experience of both the US and France. The FDD under the FTC Rule, which contains 23 mandatory items and requires disclosure at least 14 days before any agreement is signed or payment is made<sup>148</sup>, adapts it to the Civil Code because this model recognizes that while franchisors retain systemic control, franchisees deserve access to

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<sup>146</sup> Ibid, Article 612(2).

<sup>147</sup> Balanced law generally refers to a legal system or principle that strives for fairness and equilibrium, often by balancing competing interests or rights. Ni Luh Made Mahendrawati, "The Principle of Balance to Realize Justice of the Parties in Standard Agreements for Business Format", 2nd International Conference on Business Law and Local Wisdom in Tourism (ICBLT 2021), Atlantic Press, p.361.

<sup>148</sup> What You Need to Know About Federal Franchise Laws, <https://frannet.com/resources/business-opportunity-2/what-you-need-to-know-about-federal-franchise-laws/#:~:text=The%20Key%20Federal%20Law:%20FTC%20Franchise%20Rule&text=With%20a%20focus%20on%20transparency,practices%20in%20the%20franchising%20world>, accessed 04.05.2025.

critical business information to make a rational investment decision. At the time, the Loi Dubin mandates the disclosure of essential information 20 days before signing, including local market potential and financial data.

Concluding the information mentioned above, recommendations are that, Georgia should: 1) Codify a Georgian version of the FDD or Loi Dubin disclosure document, listing minimum required disclosures for example the franchisor's registration and ownership information, financial statements history, initial and ongoing fee structure, existing and planned franchise locations in the proposed territory and any litigation or bankruptcy history involving the franchisor or its executives, but It should be left open with the words "and other relevant information that can affect the decision of potential franchisee" and 2) rule a legal requirement of specific period (e.g. 14-21 days) between the disclosure and contract signing which will give the franchisee time to review the terms with legal or financial counsel. Both changes can be incorporated into Article 610 of the Civil Code of Georgia, accompanied by a straightforward remedy for non-compliance.

#### **4.3. No regulation of encroachment**

Georgian franchise law is entirely silent on encroachment, which creates legal uncertainty. Franchisees lack guaranteed territorial rights or remedies if their exclusivity is violated. This discourages investment and weakens trust in the franchising model.

In contrast, U.S. courts, especially in California, have addressed encroachment by applying the implied covenant of good faith and fair dealing. For instance, in *Postal Instant Press v. Sealy*<sup>149</sup>, the court protected a franchisee despite the absence of a territorial clause. Conversely,

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<sup>149</sup> *Postal Instant Press, Inc. v. Sealy*, No. B08112, 43 Cal. App. 4th 1704 (1996).

in *Scheck v. Burger King*<sup>150</sup>, the court upheld the franchisor's actions due to a lack of contractual protection, illustrating the importance of clear terms.

Germany addresses encroachment under general contract principles and good faith<sup>151</sup>, protecting franchisees' legitimate expectations when exclusivity is implied or understood. France enforces territorial integrity through both contractual terms and judicial review of unfair interference.<sup>152</sup>

I think, Georgia should codify franchisee territorial protection through express statutory clauses. Additionally, the law should require franchisors to disclose potential territorial expansion plans at the pre-contractual stage. Courts should also be empowered to interpret implied exclusivity considering the franchisee's legitimate expectations, consistent with the good faith principles recognized in civil law systems.

#### **4.4. Enforcement Problems in Georgian Franchising Law**

One of the most critical yet hardly discussed weaknesses in the Georgian franchising framework is the lack of effective enforcement mechanisms.<sup>153</sup> While the Civil Code of Georgia outlines the basic obligations of the franchisor and franchisee, it provides no franchise-specific procedures for enforcing rights, resolving disputes, or ensuring compensation. This deficiency significantly undermines franchisee confidence and creates a serious barrier to both domestic and international franchise growth.

In practice, disputes in Georgia must be resolved through general contract law litigation, which is slow, expensive, and inappropriate to the specialized nature of franchise relationships. For

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<sup>150</sup> *Scheck v. Burger King Corp.*, No. 89-1281-Civ., 756 F. Supp. 543 (S.D. Fla. 1991).

<sup>151</sup> Section 242 BGB.

<sup>152</sup> Franchise laws and regulations France, 2024, <https://iclg.com/practice-areas/franchise-laws-and-regulations/france> accessed 22.05.2025.

<sup>153</sup> See section 2.2.2 supra.

example, Article 614 allows the franchisee to request a fee reduction in case of a franchisor breach, but an independent expert must make the determination. However, the law fails to regulate how the expert is selected, how costs are split fairly, or how long the process should take. As a result, franchise owners may not seek damages, especially when they are faced with well-equipped franchisors.

Furthermore, the Georgian judiciary lacks experience with franchise disputes, and there are virtually no reported cases interpreting franchise-specific norms. This legal vacuum means that outcomes are unpredictable, and courts may lack the doctrinal background to evaluate the unique dynamics of asymmetry, encroachment or system modification. Without strong case law or specialized commercial courts, franchisees remain in a weak position.

By contrast, enforcement mechanisms in other jurisdictions offer valuable lessons. In the US, franchising is not only governed by disclosure rules under the FTC Franchise Rule but specific administrative procedures are also available for its enforcement. Franchisees may file complaints with the Federal Trade Commission (FTC), which has investigative powers and can impose penalties.<sup>154</sup> Additionally, franchisees can bring civil suits for fraud, unfair business practices or breach of contract. In California, state laws, such as the California Franchise Relations Act, further protect franchisees by regulating arbitration provisions, as well as termination and non-renewal. Courts are empowered to strike down oppressive contract clauses, ensuring judicial checks on franchisor abuse.<sup>155</sup>

<sup>154</sup> FTC franchise rule, Cornell Law School, Legal Information Institute, [https://www.law.cornell.edu/wex/ftc\\_franchise\\_rule#:~:text=The%20Federal%20Trade%20Commission%20\(FTC%20\)%20Franchise,the%20relevant%20information%20about%20the%20franchise%20](https://www.law.cornell.edu/wex/ftc_franchise_rule#:~:text=The%20Federal%20Trade%20Commission%20(FTC%20)%20Franchise,the%20relevant%20information%20about%20the%20franchise%20), accessed 23.05.2025.

<sup>155</sup> What's new in 2023 for franchisors, <https://dfpi.ca.gov/regulated-industries/franchises/whats-new-in-2023-for-franchisors/#:~:text=Changes%20to%20the%20California%20Franchise,declared%20state%20or%20federal%20emergency>, accessed 23.05.2025.



In Germany, enforcement is handled through general contract law, with the doctrine of good faith and culpa in contrahendo being most frequently exploited to protect franchisees.<sup>156</sup> Principles enable courts to hold franchisors accountable for unfair conduct. German courts have increasingly accepted the franchisee's weaker bargaining position and developed case law that provides de facto protection in disputes even in the absence of franchise-specific legislation.<sup>157</sup>

France, meanwhile, combines statutory enforcement (under the Loi Doubin) with strong judicial review. French courts frequently annul franchise agreements where disclosure was defective or clauses were unfairly imbalanced. Notably, in the Subway case<sup>158</sup>, the Paris Commercial Court declared numerous clauses null due to "significant imbalance," setting a precedent for active court enforcement in asymmetric relationships.

I believe the best recommendation for Georgia regarding Article 614 and enforceability would be to specify the article, which should include: who appoints the independent expert, how expected costs are allocated, a timeline for fee assessments and challenges, and whether the expert's findings are reviewable or binding. This reform would enhance accessibility, fairness, and legal certainty in enforcement.<sup>159</sup>

#### 4.5. Proposed Draft Amendments

Considering the regulatory gaps identified in the previous sections, the subsection introduces draft amendments to the Georgian Civil Code concerning franchise agreements. These proposals were developed as part of this research. They aim to improve legal clarity, protect the interests of both franchisors and franchisees and promote fair dealings. However, these drafts are presented

<sup>156</sup> Pre-contractual information obligations of franchising in Germany, 2025 <https://www.roedl.com/insights/germany-franchise-pre-contractual-obligations>, accessed 23.05.2025.

<sup>157</sup> Dr Mark Abell and Victoria Hobbs, The Duty of good faith in franchise agreements- a comparative study of the civil and common law approaches in the EU, Bird & Bird, London, p.8.

<sup>158</sup> Decision of the Paris Commercial Court, 13.10.2020, N:RG 2017005123.

<sup>159</sup> See section 4.5 infra.

carefully, reflecting the supervisor's advice to avoid overly strict or exaggerated provisions. Care has been taken to incorporate flexible and balanced language, consistent with doctrines such as "bespeaks caution"<sup>160</sup>, which emphasize the importance of risk disclosure and contextual understanding in contractual and pre-contractual obligations.

Draft for Article 610, which currently looks like this.

### **Obligation not to disclose confidential information**

"At the time of execution of the contract, the parties shall openly and completely inform each other about the circumstances relating to the franchise, especially the franchise system, and communicate the information to each other in good faith. The parties shall not disclose the information disclosed to them even if the agreement is not executed."

My draft-proposal for the article would be the following text:

### **"Article 610. Pre-contractual Obligation and restriction of confidential information disclosure**

1. At the time of executing the contract, the parties shall openly and completely inform each other about the circumstances relating to the franchise, especially the franchise system, and communicate this information to each other in good faith.
2. The franchisor must provide the prospective franchisee with a written disclosure document at least 20 days before the conclusion of the franchise agreement.
3. The disclosure document must include:
  - a) The franchisor's legal identity and corporate history;

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<sup>160</sup> The bespeaks caution doctrine is a legal principle developed by courts that shields securities issuers and their representatives from fraud liability related to forward-looking statements, as long as those statements are accompanied by sufficient warnings. Under this doctrine, such statements are not considered misleading if they include clear disclosures about potential risks that could significantly affect the projected outcomes. [https://uk.practicallaw.thomsonreuters.com/w-000-3638?transitionType=Default&contextData=\(sc.Default\)&firstPage=true](https://uk.practicallaw.thomsonreuters.com/w-000-3638?transitionType=Default&contextData=(sc.Default)&firstPage=true) accessed 27.05.2025.

- b) financial statements for the past two years;
  - c) A list of current and former franchisees within the last 3 years;
  - d) A description of fees, royalties, and ongoing obligations;
  - e) Territorial rights and exclusivity, if applicable;
  - f) Terms and conditions of renewal, termination, and dispute resolution mechanisms;
  - g) Any pending actions, material actions, and prior actions against the franchise. if exist;
  - h) Any material information that could reasonably be expected to influence the prospective franchisee's decision to enter into the agreement, including commercially sensitive data, the omission of which could have led to a different contractual outcome.
4. Failure to disclose the above-mentioned important information may allow the franchisee to seek remedies, including damages or cancellation, within one year from the date of signing the agreement, provided the omission can be shown to have significantly impacted their decision to enter into the contract.
  5. The parties shall not disclose the information disclosed to them even if the agreement is not executed.”

As I mentioned in the thesis, there is no clause regarding encroachment and here is my draft-proposal:

#### **Article X: Territorial exclusivity and Encroachment**

1. If a franchise agreement grants territorial exclusivity, the franchisor shall not establish or authorize another franchise or company-operated unit within that territory during the term of the contract.

2. A material breach of this obligation may entitle the franchisee to seek compensation for damages and, where the breach substantially undermines the franchise relationship, to terminate the agreement for cause.

Regarding the asymmetry, after articles 611-613, which cover the form of contract, duration of the contract, and loyal competition, there may be added:

#### **Article X: Regulation of Contractual Asymmetry and Franchisee Protection**

1. A franchise agreement may establish differentiated obligations between the franchisor and franchisee, provided that such asymmetry:
  - a) Is proportionate to the legitimate interests of protecting the franchisor's brand and business model; and
  - b) Does not deprive the franchisee of essential legal remedies or the ability to safeguard their commercial interests reasonably.
2. The franchisor shall not unilaterally modify key operational terms of the agreement without:
  - a) Providing written notice with reasonable advance time; and
  - b) Demonstrating that the modification is necessary to preserve brand integrity or market competitiveness.

Lastly, article 614 is now like this

#### **Liability of a franchisor**

“The franchiser shall be liable for the rights and information specified by the franchise system.

If he/she breaches the contractual obligation due to his/her fault, the franchisee may reduce the

franchise fee. The amount of the reduction shall be determined finally by an independent expert, the expenses of whose services shall be borne by the parties.”

And it should be changed like this:

**Article 614: Liability of a franchisor**

1. The franchiser shall be liable for the rights and information specified by the franchise system. If he/she breaches the contractual obligation due to his/her fault, the franchisee may reduce the franchise fee. The amount of the reduction shall be determined finally by an independent expert, the expenses of whose services shall be borne by the parties.
2. The independent expert shall be:
  - a) Appointed by mutual agreement of the parties within 10 days of the franchisee’s written request; or
  - b) If no agreement is reached, designated by the court upon application by either party.
3. The costs of the expert shall be shared equally between the parties unless the expert or court determines otherwise based on the outcome of the evaluation.
4. The expert shall complete the evaluation and submit a written opinion within 15 calendar days of appointment unless extended for the good cause by agreement of the parties.
5. The expert’s opinion shall be considered binding unless a manifest error or fundamental procedural flaw is demonstrated, in which case either party may seek judicial review or request a supplementary evaluation.

## Conclusion

Franchising has become a globally recognized model for business expansion which connects brand standardization to local entrepreneurship. In Georgia, however, the full potential of franchising as a driver of economic growth, innovation and job creation remains untapped, mainly due to the disadvantages of its legal framework. Although the Civil Code of Georgia nominally regulates franchise agreements through Articles 607–614, the provisions fail to address essential regulatory functions such as disclosure, territorial rights, conflict settlement, and judicial oversight. This thesis has demonstrated that Georgia's underdeveloped regulation of franchises undermines the trust of domestic and foreign investors, leading to an imbalanced contractual environment.

The critical issue identified in this thesis is the structural asymmetry between franchisors and franchisees, where the franchisor overwhelmingly holds power, information, and flexibility. While some level of asymmetry is internal to the franchising model and, as Professor Tibor Tajti has emphasized, may even be necessary to maintain the integrity of the brand, unchecked imbalance undermines fair dealing. The Georgian legal framework currently lacks counterbalancing measures, statutory disclosure obligations, detailed franchisee protections, and practical remedies for unfair terms. The system is doctrinally unsound, practically burdensome, and conceptually defective. Comparative legal analysis reveals that more advanced jurisdictions mitigate these power imbalances through different mechanisms.

The thesis proposes a set of tailored reforms grounded in international best practices but adapted to Georgia's legal and economic context. First, the Civil Code should be amended to include a mandatory disclosure regime, modeled on the U.S. FDD or the French Loi Doubin. Required items should consist of financial performance representations, fee structures, litigation history, support obligations, and territorial policies. Second, Article 614 must be reformulated to clarify procedural aspects of dispute resolution and enable cost-effective, fair mechanisms for fee

adjustment. Courts should be trained and empowered to apply doctrines of good faith and fair dealing with interpreting franchise contracts. Third, Georgia should codify territorial protections to prevent encroachment, or at a minimum, require franchisors to disclose potential expansion plans that may impact franchisee viability. Finally, Georgia should encourage the publication of anonymized case law to build judicial consistency and legal certainty.

To attract international franchisors, Georgia must implement legal reforms that increase predictability and align with international norms. The country already offers strategic advantages, ranking high in ease of doing business, boasting a growing consumer market, and enjoying free trade access to the EU, and other key markets. Combined with low market entry costs, a favorable tax regime, and a culturally adaptive consumer base, Georgia is well-positioned to become a regional franchise hub.

These reforms would serve multiple purposes. For franchisees, they offer transparency, informed decision-making, and legal recourse. The benefits are substantial. They start their business with a tested model. They receive training and support, find financing more easily, and benefit from ongoing operational guidance. This is perfect for first-time entrepreneurs. For franchisors, this helps maintain system integrity. For franchisors, this ensures system integrity, reduces litigation risk, and clarifies obligations. For the Georgian state, stimulating investment, promoting entrepreneurship, and enhancing alignment with European legal standards are critical, as Georgia deepens its economic and political ties with the European Union.

The study concludes that franchising in Georgia should not be perceived as a private contractual matter. It is a public interest tied to economic development. Legal clarity and enforceability are essential for transforming franchising from a niche, foreign-led practice into a mainstream model

for national business growth. A modern, balanced, and enforceable legal framework is not only feasible but also necessary.

Georgia does not need to reinvent the wheel. By selectively integrating proven legal doctrines and policy instruments from leading jurisdictions and by learning from the experiences of developed franchise systems, the country can develop a franchise regulatory framework that is clear and fair.

Lastly, Georgia must recognize that franchising is not just a private commercial tool, it is a national economic strategy and a tool for business growth. A clear, balanced, and enforceable legal framework will not only foster fairness between franchisors and franchisees, but also stimulate domestic entrepreneurship, create jobs, attract foreign investment, and position Georgia as a competitive player in the global franchise market.



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