

## **Alert | Franchise & Distribution**



**January 2020**

### **Brazil's New Legal Framework for Franchising**

On Dec. 27, 2019, Brazilian President Jair Bolsonaro sanctioned Law # 13966/19 (the “New Franchise Law”), which revokes and replaces Law #8955/94, and will serve as the new legal framework for franchising in Brazil. The New Franchise Law will take effect at the end of March 2020.

The New Franchise Law is intended to help remove potential barriers to and promote franchising in Brazil. We highlight below the main changes brought by the New Franchise Law.

#### **The Franchisee Is Neither a Consumer Nor an Employee**

The definition of “corporate franchise” in the New Franchise Law reinforces that the relationship between the franchisor and its franchisees amounts neither to a consumer relationship nor an employment relationship, with respect to both the franchisee and its employees. This new definition strengthens the franchise model, because some Brazilian courts have erroneously characterized the franchisee as a consumer or an employee of the franchisor. The New Franchise Law also alleviates the concern that the training provided by franchisors to franchisees and their respective employees, as part of the transfer of know-how essential to the franchise relationship, could establish an employment relationship between them. The New Franchise Law clarifies that franchisors and their franchisees are autonomous and independent of one another, and the franchisee is solely responsible for its employees, including for the labor obligations related to them.

## New Disclosures in the Franchise Offering Circular Under the New Franchise Law

Under the New Franchise Law, the franchisor will continue to have the obligation to deliver the franchise offering circular to prospective franchisees 10 days before the execution of any franchise agreement and before the franchisor may receive any franchise fee or royalties from the prospective franchisee.

The franchise offering circular must be written in Portuguese on an objective and accessible basis. Article 2 of the New Franchise Law specifies a list of the minimum and mandatory information the offering circular must contain. This list includes some disclosures not required under the current franchise law, such as:

- **Periodic compensation.** The New Franchise Law requires the offering circular to disclose in detail the periodic compensation payable by the franchisee to the franchisor for the use of the system, the brand, and other intellectual property rights belonging to the franchisor. The New Franchise Law is broader in this respect since the current franchise law only requires disclosure with respect to compensation for use of the brand.
- **Relationship between the franchisors and its former franchisees.** The New Franchise Law requires the offering circular to include a full list of all the franchisees, sub-franchisees, or sub-franchisors of the franchise network. The New Franchise Law also requires a franchisor to disclose the names, addresses, and telephone numbers of franchisees who have terminated their agreements within the last 24 months; the current franchise law only requires a 12-month look back. In addition, while the New Franchise Law does not specifically address the issue, local franchise practitioners understand that the list of franchisees is to cover both franchisees operating in Brazil and in other jurisdictions.
- **Territory.** The current franchise law requires the franchisor to disclose in the offering circular how territoriality is addressed in the franchise agreement. Specifically, (i) whether exclusivity or preference is granted, and (ii) whether it is possible for the franchisee to sell, export, or provide services outside the territory defined in the franchise agreement. The New Franchise Law requires franchisors to also disclose in the offering circular information related to the franchisor's plans for the expansion and the opening of new outlets in the franchisee's assigned territory, if any, and the franchisor's rules on territorial competition among its franchisees.
- **What is offered by the franchisor.** The New Franchise Law requires more comprehensive disclosure in the offering circular regarding the franchisor's support obligations, and any conditions for such support, as well as whether the franchisor will offer technological innovations to its franchisees, and the method in which it plans to do so.
- **Intellectual Property.** The current franchise law requires the franchisor to disclose the franchisor's trademarks and patents related to the franchise, and their status before the Brazilian National Institute of Industrial Property (INPI). In addition to disclosure regarding the trademarks and patents, the New Franchise Law requires the franchisor to disclose the status of other intellectual property rights related to the franchise, such as copyrights, industrial designs, and plant varieties. Such new disclosures must include the full identification of the intellectual property, including the registration number, the class and subclass, the relevant entities owning and licensing the intellectual property, and, in the case of plant varieties, the status before the Brazilian National Service for the Protection of Plant Varieties (SNPC).
- **News on the content of the offering circular and restatement of some practices.** The New Franchise Law expressly requires that the franchisor disclose the following items in the offering circular, which disclosures have been a common practice for many franchisors under the current franchise law even though not expressly required.

- *Succession and assignment.* The franchisor’s rules for transfer / assignment or succession.
  - *Contractual term.* The term of the franchise agreement and any conditions to renewal.
  - *Penalties.* The circumstances warranting the application of penalties, fines, or indemnifications and their respective amounts, as set forth in the franchise agreement.
  - *Minimum quotas for purchases.* The existence, if any, of minimum quotas of purchases by the franchisee from the franchisor or third parties designated by the franchisor, and any circumstances where the franchisor or the third parties would not sell the franchisee the products or services required by the franchisor.
  - *Board or association of franchisees.* The existence, if any, of a board or association of franchisees, indicating the attributions and authority of the board and mechanisms for representation before the franchisor. The New Franchise Law also requires the offering circular to disclose the board or association’s ability to direct and audit the franchisor’s advertising fund expenditures. On this matter, it is worth noting that the Economic Matters Committee (CAE) vetoed, on Oct. 22, 2019, an earlier amendment to the original bill of law, which intended to compel franchise networks with more than 50 units to structure a board or an association of franchisees. Fortunately, based on the recommendation of the Associação Brasileira de Franchising (Brazilian Association of Franchising - ABF), the requirement was rejected because, besides violating the constitutional principle of free enterprise and free association, it would have caused franchisors and franchisees an unnecessary burden in cases where the networks did not want to create such a board or association.
  - *Rules of competition between franchisor and franchisees.* The franchisor’s rules limiting competition between the franchisor and its franchisees, and among the franchisees, during the term of the franchise agreement. This disclosure includes the territorial scope, the duration of the restriction, and the penalties in the case of noncompliance.
- **Noncompliance with the obligation of delivering the offering circular.** Under the current franchise law, if a franchisee was not disclosed with an offering circular or was disclosed with an incomplete offering circular, the franchisee could nullify the franchise agreement and request a refund of all franchise fees paid to franchisor during the term of the franchise agreement, plus interest, monetary adjustments and losses and damages. The New Franchise Law provides franchisees with a similar remedy for incomplete or non-disclosure; however, the language in the New Franchise Law excludes interest, losses, and damages from its text.
  - **Subleasing by the franchisor.** One of the most significant innovations of the New Franchise Law pertains to instances where the franchisor subleases to the franchisee the premises where the franchised business is located. In such instances, the New Franchise Law requires: (i) that both the franchisor and franchisee have standing to file an action for renewal of the property lease agreement, preventing the exclusion of the franchisor or franchisee from the lease and sublease agreement upon renewal, except in the cases of default of the lease or sublease, or the franchise agreement, and (ii) that while the rent amount to be paid by the franchisee to the franchisor under a sublease may be higher than the amount the franchisor pays to the owner of the property in the master lease for the premises, the franchise agreement and offering circular clearly disclose the possibility for the higher rent amount under the sublease agreement, and the higher rent amount does not cause an excessive burden on the franchisee, who is guaranteed an economic and financial balance under the sublease during the term of the franchise agreement.
  - **Law applicable to the franchise agreement and jurisdiction.** The New Franchise Law requires franchise agreements where both parties and all franchised locations are located exclusively in Brazil to be governed by Brazilian law. On the other hand, the New Franchise Law expressly permits the contracting parties to international franchise agreements to elect for the agreement to be governed by

the laws of the jurisdiction of one of the countries of domicile, and for disputes under the international franchise agreement to be settled in such jurisdiction.

- **International franchise agreements.** The New Franchise Law requires the contracting parties to international franchise agreements to both designate and maintain a legal representative, or an attorney, duly identified and domiciled in the country of the jurisdiction elected to govern disputes between the parties. The legal representative must have authority to represent the respective party administratively and in courts, including for service of process. The New Franchise Law also requires international franchise agreements to be originally written in Portuguese or translated into Portuguese, with the cost to be borne by the franchisor.
- **Arbitration.** The New Franchise Law expressly permits the parties to a franchise agreement to elect an arbitral tribunal for resolving disputes related to the franchise agreement, a common practice for many franchisors under the current franchise law, even though not previously expressly addressed.

Although the New Franchise Law contains several provisions of the current franchise law, it attempts to settle and clarify certain issues that have threatened the franchise model and the ability of the parties to freely negotiate the terms of the franchise agreement. With these potential barriers now removed, Brazil is once again an attractive market for domestic and international franchise development.

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