

# Franchise

in Israel

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**Correct on**

## Contributors

### Israel



**Orit Gonen**  
orgonen@gilatadv.co.il  
*Reinhold Cohn Group*



## BUSINESS OVERVIEW

### Types of vehicle

What forms of business entities are relevant to the typical franchisor?

Most franchisors in Israel are incorporated companies (private or public, domestic or foreign) or partnerships. A franchisor is rarely a self-employed individual.

### Regulation of business formation

What laws and agencies govern the formation of business entities?

Business entities such as companies (including branches) or partnerships are formed under the Companies Law 1999 or the Partnership Ordinance 1975, respectively, and registered in the relevant register.

### Requirements for forming a business

Provide an overview of the requirements for forming and maintaining a business entity.

Establishing a business entity in Israel requires establishing a company (or partnership). Any international company wishing to conduct business in Israel should be registered as either a branch or a subsidiary. In any case, a local address is required. Upon commencement of its activity, the business should be registered with the relevant tax authorities. Maintaining a corporation is subject to the payment of annual fees and the submission of annual reports approved by the company's board of directors. Under the Companies Law, local Israeli companies and branches of foreign entities are under the obligation to appoint a certified public accountant (CPA) or an accounting firm serving as an independent auditor. The CPA is appointed by the company's shareholders in the annual general shareholders meeting.

### Restrictions on foreign investors

What restrictions apply to foreign business entities and foreign investment?

All foreign entities wishing to do business in Israel should establish a subsidiary or branch. Foreign entities are required to provide a local address. Foreign investments should comply with anti-money laundering regulations. Unless dealing with defence or banking, there are no restrictions on foreign ownership of a business entity. Any foreign business entity or person starting to conduct business in Israel is required to appoint a local value added tax (VAT) representative whose permanent place of residence is in Israel and who assumes full responsibility for handling all VAT matters, if applicable.

### Taxation

Briefly describe the aspects of the tax system relevant to franchisors. How are foreign businesses and individuals taxed?

Incorporated businesses are subject to regular income tax (corporate tax) imposed on taxable transactions. Certain transactions trigger payment of VAT. As of 2019 Israel is party to over 50 double tax treaties essentially following the model of the Organisation for Economic Cooperation and Development. A foreign resident entity might be exempt from

corporate tax to the extent that its activities do not constitute a permanent establishment under the applicable tax treaty. There is no detailed legislation or Israeli court decision that provides a clear test under which it is possible to determine whether a non-resident has a taxable presence under Israeli tax law. Thus, where there is no tax treaty protection, a non-resident is subject to tax on income accrued or derived in Israel.

The tax is calculated based on the actual income of the business entity or person from its activity in Israel. Income tax is paid on an annual basis and might be subject to payments on-account. VAT, when applicable, is paid on a monthly or bimonthly basis depending on the scope of transactions. A branch of a non-Israeli entity is taxed in Israel on the profits that the branch derives from its Israeli activities, while a local subsidiary is generally taxed on its worldwide income. The rate of income tax imposed on corporations in Israel is currently 23%; profits of a branch allocable to Israel are thus subject to such rate. Lastly, social security payments are relevant to a business entity doing business in Israel and hiring personnel.

In a recent decision, the Supreme Court held that the payment of royalties or management fees by the franchisee to the franchisor will be considered as part of the purchase price of the goods and taken into account in calculating the custom fees due by the franchisee when such payments are a pre-condition to the purchase of the goods by the franchisee from the franchisor. This decision might affect the financial negotiations between franchisors and franchisees.

## Labour and employment

Are there any relevant labour and employment considerations for typical franchisors?

Generally, a franchisor's employment relationship with its employees working in Israel is subject to Israeli law. Parties to an employment agreement may determine a different governing law; however, Israeli labour courts seldom apply foreign law, which is less favourable to employees working in Israel than Israeli law.

As long as a clear separation between the franchisee and the franchisor is kept under the franchise agreement and de facto, the risk that the franchisee's employees will be considered franchisor employees is rather low. A franchise agreement should include a specific indemnification clause to reduce the franchisor's risk of being liable for any payments to franchisor employees.

## Intellectual property

How are trademarks and know-how protected?

Any domestic or foreign franchisor may apply to register its trademarks for goods and services with the Israeli Trademark Office in order to ensure its exclusive right to use it. The trademark registration is valid as long as the trademark is used in Israel. The licence granted to the franchisee to use the franchisor's trademark should be recorded for its validation and to ensure that use of the trademark by the franchisee is attributed to its registered owner. Israeli law provides for enforcement of non-registered trademarks as well. Know-how is protected either as a patent (provided it is patentable and registrable) or as a trade secret under the Commercial Tort Law 1999. For the sake of enforcing the protection, the know-how should be kept a secret. Once it reaches the public domain, the know-how is no longer protectable.

## Real estate

## What are the relevant aspects of the real estate market and real estate law?

There are no legal restrictions relating to foreign or domestic franchisors in respect of purchasing or leasing real estate.

## Franchising in the market

### How widespread is franchising in your jurisdiction? In which sectors is franchising common?

Franchising is rather common in the Israeli market, especially in the food and beverage industry, as well as for merchandising, especially in the apparel and fashion industry.

## LAWS AND AGENCIES REGULATING THE OFFER AND SALE OF FRANCHISES

### Legal definition

#### What is the legal definition of a franchise?

The only definition of 'franchise agreement' in Israeli legislation can be found in regulations enacted under the Commercial Competition Law 1988, which provide block exemption to a franchise agreement in certain circumstances and under certain conditions. The definition in the regulations is (translated):

'Franchise Agreement' a contract under which a franchisor grants the franchisee the right to use the franchise for the purposes of marketing certain goods or types of goods, including each of the following:

- (1) use of a uniform trade name or trademark or service mark, and uniform characteristics of the goods being sold or of the sale and execution, which are material to the marketing and sale of the goods;
- (2) transfer of knowledge from the franchisor to the franchisee which is material to the marketing and sale of the goods;
- (3) commercial or technical assistance from the franchisor to the franchisee, during the term of the agreement.

### Franchise laws and agencies

#### Which laws and government agencies regulate the offer and sale of franchises?

Israel has no specific law or regulation for franchises. Franchises in Israel are regulated under contract law, IP laws and commercial competition law, as well as case law. No government agency regulates franchises in Israel.

### Principal franchise requirements

#### Describe the relevant requirements of these laws and agencies.

Not applicable.

### Exemptions

## What are the exemptions and exclusions from any franchise laws and regulations?

Franchise agreements may be exempted from the Commercial Competition Law under a block exemption and are thus not considered restrictive arrangements banned under this law, provided that the agreements comply with the requirements set out in the rules for franchise agreements.

The exemption under these rules will not apply where:

- the parties to the agreement are actual competitors;
- a party has monopoly power in the relevant product market or in an adjacent market;
- the agreement's duration is 10 years or longer; or
- the agreement includes restricting stipulations such as:
  - restriction of the franchisor from using licensed know-how after the term of the agreement, even when such know-how is in the public domain;
  - preventing the franchisee from initiating judicial review of the validity of the rights in know-how transferred from the franchisor to the franchisee or other IP rights;
  - preventing the franchisee from selling or supplying goods to consumers outside the territory defined in the agreement; and
  - other restrictions that are meant only to reduce competition or are not necessary to fulfil its principal.

The Commercial Competition Law deems not restrictive any arrangement whose restrictions involve the right to use a patent, trademark, copyright or proprietary right, provided that:

- the arrangement is made between the owner of the right and the party that receives the right to use such right; and
- where the right is subject to registration by law, the right is registered accordingly.

## Franchisor eligibility

Does any law or regulation create a requirement that must be met before a franchisor may offer franchises?

There is no such rule or law in Israel.

## Franchisee and supplier selection

Are there any laws, regulations or government policies that restrict the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers?

No specific rules or laws for franchisee selection exist, unless the franchisor is a local government or public body subject to the Mandatory Tender Act 1992.

## Pre-contractual disclosure

What is the compliance procedure for making pre-contractual disclosure in your country? How often must the disclosures be updated?

There are no requirements in respect of pre-contractual disclosure other than under contract law, which requires that the parties negotiate in good faith. There is no specific requirement for updating the disclosure, except if such requirement derives from the duty of the parties to act in good faith for the duration of the agreement.

### **Pre-sale disclosure to sub-franchisees**

In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

There is no specific rule except the requirement to negotiate in good faith.

### **Due diligence**

What due diligence should the parties undertake before entering a franchise relationship?

A customary due diligence should be undertaken, as in any other transaction.

Before starting to use a new brand in the Israeli market, parties should clear their right to do so given that under Israeli law one may accrue rights in a trademark through use and be entitled to protection even if the trademark is not registered; thorough research of the market should be performed before establishing franchises in the market.

### **What must be disclosed**

What information must the disclosure document contain?

There is no specific requirement for a disclosure document.

### **Continuing disclosure**

Is there any obligation for continuing disclosure?

Except as required under the good-faith principle, whether during the negotiations or throughout the contractual relationship, no specific requirement for continuing disclosure exists.

### **Disclosure requirements – enforcement**

How do the relevant government agencies enforce the disclosure requirements?

Not relevant.

### **Disclosure violations – relief for franchisees**

What actions can franchisees take to obtain relief for violations of disclosure requirements? What are the legal remedies for such violations? How are damages calculated? If the franchisee can cancel or rescind the franchise contract, is the franchisee also entitled to reimbursement or damages?

Breach of the duty to disclose under the general duty to act in good faith during the pre-contractual period and negotiations entitles the franchisee to damages. Such damages are usually punitive, calculated on the basis of the actual loss incurred by the franchisee due to the negotiations; however, in extreme circumstances such as gross bad faith or intentional deceit, the courts might consider awarding reliance damages calculated on the basis of the expected gain of the franchisee had the agreement been executed.

### **Disclosure violations – apportionment of liability**

In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

Party liability is generally regulated under the relevant agreements. Officers and directors of the violating party will be exposed to liability under the Companies Law 1999 insofar as the circumstances allow for the corporate veil to be lifted. Such extreme circumstances usually involve fraud or wilful deceit.

### **General rules on offer and sale**

In addition to any laws or government agencies that specifically regulate offering and selling franchises, what are the general principles of law that affect the offer and sale of franchises? What other regulations or government agencies or industry codes of conduct may affect the offer and sale of franchises?

The duty of good faith during negotiations, the 'culpa in contrahendo' principle, is applied under the Contract (General Part) Law 1973. The law does not prescribe the extent of disclosure and requires each negotiating party to act in a 'customary manner' and in good faith, thus leaving it to the courts to decide. The Standard Contract Law 1982 applies when franchisors act under standard agreements. Pursuant to this law, the courts may find certain terms to be unreasonable practice, unfair or oppressive. The law further allows franchisors to seek advance approval of the standard agreement. Such approval serves as a declaration that the standard terms are not oppressive.

### **General rules on pre-sale disclosure**

Other than franchise-specific rules on what disclosures a franchisor should make to a potential franchisee or a franchisee should make to a sub-franchisee regarding predecessors, litigation, trademarks, fees, etc, are there any general rules on pre-sale disclosure that might apply to such transactions?

No, as long as the parties negotiate in good faith.

### **Fraudulent sale**

What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises? How does this protection differ from the protection provided under franchise sales disclosure laws?

There is no difference between a franchisee and any other party to a contract facing fraudulent or deceptive practices in the framework of negotiations. The law provides for reliance damages; however, in some extreme cases Israeli courts have granted performance damages.

## **LEGAL RESTRICTIONS ON FRANCHISE CONTRACTS AND THE RELATIONSHIP BETWEEN THE**

### **Franchise relationship laws**

Are there specific laws regulating the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

There are no specific laws; however, Israeli courts regard the franchisor-franchisee relationship to be a trust-based relationship and therefore rarely enforce such relationship where a loss of trust transpires between the parties.

### **Operational compliance**

What mechanisms are commonly incorporated in agreements to ensure operational compliance and standards?

It is common to require periodic reports and to allow the franchisor to audit the franchisee's business and inspect its books, especially if the royalties are calculated based on the income of the franchise or any other measurable volume of activity. The franchisor is further entitled and expected to inspect and control the way its intellectual property is used by the franchisee and the compliance with its code and standards.

### **Amendment of operational terms**

May the franchisor unilaterally change operational terms and standards during the franchise relationship?

It depends on the agreement between the parties. Unilateral changes in the agreement terms without a proper agreed-to mechanism are not recognised under Israeli law.

### **Other laws affecting franchise relations**

Do other laws affect the franchise relationship?

No other laws affect the franchise relationship.

**Policy affecting franchise relations**

Do other government or trade association policies affect the franchise relationship?

No.

**Termination by franchisor**

In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

Termination of a franchise agreement is subject to specific stipulations agreed to by the parties. Under Israeli contract law, any party may terminate an agreement in case of material breach of the agreement subject to certain conditions. An agreement may be terminated if the franchisor was misled by the franchisee in negotiations and the franchisor may prove that, but for the misleading information, it would not have entered into the agreement.

Where the agreement is unlimited in duration, any party may terminate it, subject to reasonable prior notice.

**Termination by franchisee**

In what circumstances may a franchisee terminate a franchise relationship?

A franchisee may terminate a franchise relationship in the same circumstances as those allowing the franchisor to terminate the relationship.

**Renewal**

How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

No formal requirement applies.

**Refusal to renew**

May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

It depends on the parties' agreement.

**Transfer restrictions**

May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

Indeed, such restriction is allowed (and customary), especially given the fact that Israeli courts consider the franchisor-franchisee relationship to be based on party trust.

**Fees**

Are there laws or regulations affecting the nature, amount or payment of fees?

No.

**Usury**

Are there restrictions on the amount of interest that can be charged on overdue payments?

No.

**Foreign exchange controls**

Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

No; however, all payments should comply with the anti-money laundering regulations applicable to banks in Israel.

**Confidentiality covenant enforceability**

Are confidentiality covenants in franchise agreements enforceable?

Yes, as long as the information covered may be regarded as a trade secret.

**Good-faith obligation**

Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

Yes. Bad faith might be regarded as a breach of the franchise agreement, thus allowing the cancellation of the agreement under certain conditions.

**Franchisees as consumers**

Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

No.

It is worth noting that under the Defective Products Law 1980, a strict liability standard is imposed on the manufacturer, importer, seller and distributor with respect to personal injury resulting from a defective product. Such liability should be covered in the franchise agreement, as should the product liability insurance and its costs.

### Language of the agreement

Must disclosure documents and franchise agreements be in the language of your country?

There is no such demand; however, the language of the agreement should be understood by both parties in order to estop any argument based on misunderstanding of the stipulations of the agreement.

### Restrictions on franchisees

Describe the types of restrictions placed on the franchisees in franchise contracts.

It is customary to include in franchise agreements restrictions such as:

- exclusive territories;
- restrictions on sources from whom a franchisee may purchase or lease goods or services (restrictions on the purchase of goods and services from other franchisees of the same franchisor or restrictions on the source of goods even if such are in line with the franchisees business are forbidden under the block exemption of franchise agreements);
- restrictions on the customers to whom the franchisee is entitled to sell the franchisor's products or services;
- restrictions on advertisement of the goods or services;
- prohibition on franchisees soliciting the franchisor's or other franchisees' employees;
- non-competition;
- confidentiality;
- governing law;
- dispute resolution;
- audit rights;
- insurance;
- indemnification obligations;
- restriction on the use of IP assets other than as per the licence granted under the agreement (eg, restriction to apply for the registration of the trademarks owned and used by the franchisor or any confusing similar trademark);
- assuming full liability to the employees of the franchisee; and
- post-agreement restrictions relating to the use of the franchisor's intellectual property.

### Competition law

Describe the aspects of competition law in your country that are relevant to the typical franchisor. How are they enforced?

Competition in the Israeli market is regulated under the Commercial Competition Law 1988 (formerly known as the Restrictive Trade Practice Law). Franchise agreements are exempted from the prohibitions under the law according to a specific block exemption unless:

- the parties to the agreement are actual competitors;
- a party has monopoly power in the relevant product market or in an adjacent market; or
- the agreement's duration is 10 years or longer.

Franchise contracts, which are covered unless the franchisee's market share exceeds 30%, can control resale prices without restriction and may also restrict the franchisee from engaging in 'active sales' promotion' outside the assigned franchise territory.

The block exemption on franchise agreement protects ancillary restrictions included in a franchise agreement, provided that the restrictions are required for the realisation of the agreement's objective and do not cause substantial harm to competition.

The block exemption on franchise agreement further disqualifies certain terms barring the franchisee.

The Israel Competition Authority oversees enforcement of the law when it is violated. Enforcement proceedings begin with an investigation that might lead to financial sanction and/or criminal charges.

The franchise agreement should be carefully drafted in order to comply with the exemption for franchise agreements.

### **Courts and dispute resolution**

Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The Israeli courts were established under Israel's Basic Law: The Judiciary, under which a single system of courts of law exists. The courts of law include the Supreme Court, five district courts and some magistrate courts (acting as first instance for most cases in Israel).

There are also courts of traffic offences, family courts and juvenile courts, and national and regional labour courts.

The courts are independent and constitute a separate unit under the Ministry of Justice.

### **Arbitration – advantages for franchisors**

Describe the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction.

Arbitration is common in franchise transactions in the Israeli market. The advantages of arbitration are:

- the freedom of the parties to choose their arbitrator;
- the possible efficiency of the process;
- the freedom of the parties to agree that the arbitrator will not be bound by procedural regulations or local evidence law;
- the freedom of the parties to agree that the decision is final and may not be appealed; and
- the freedom of the parties to set in advance the venue and language of the process.

The disadvantages are:

- the cost of the proceedings given that the parties should bear the fees of the arbitrator (subject to its final decision);
- the limited enforceability of orders issued by the arbitrator granting interim relief (although the district court is authorised to provide such relief under specific circumstances); and
- the fact that the decision may not be appealed unless the parties agree otherwise (even then, the grounds of appeal are rather limited).

**National treatment**

In what respects, if at all, are foreign franchisors treated differently from domestic franchisors?

Domestic and foreign franchisors are treated equally by the legal system in Israel.

**UPDATE AND TRENDS****New legislation and regulation**

Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

A committee of the Israeli Bar Association has expressed its interest in promoting legislation regulating franchise agreements; however, no measure has been taken except publishing a short article in the Bar's Journal in July 2018.

**LAW STATED DATE****Correct on**

Give the date on which the above content is accurate.

November 2019.