
THE FRANCHISE LAW REVIEW

FOURTH EDITION

EDITOR
MARK ABELL

LAW BUSINESS RESEARCH

This book is dedicated to
JOHN NELSON-JONES,
an exceptional lawyer and mentor,
who passed the wonder and pleasure of
practising law from one generation to another,
with an unsurpassed generosity of spirit.

THE FRANCHISE LAW REVIEW

Fourth Edition

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EDITOR'S PREFACE

This book is dedicated to my dear, recently deceased mentor, John Nelson-Jones, who took me under his wing and first introduced me to international franchising in the early 1980s. At that time I had no idea what an incredible professional journey I was embarking upon. Without John's immense intellect, keen understanding of the commercial world and enormous generosity of spirit, supporting and encouraging me, I may well have given it up as being far too much of a challenge for a young lawyer. It soon became clear to me that to advise clients upon franchising one needed to have a strong understanding of a wide range of legal disciplines, from competition law and intellectual property through real estate, contract, commercial, corporate, tax and private international law to the boundaries of new and previously undreamed of areas of jurisprudence in jurisdictions far beyond one's own. Who in the early 1980s, for example, had even imagined areas of law such as privacy and data protection, which now play such an important role in how franchising is structured and regulated across the globe? It all seemed an incredible intellectual and professional challenge in respect of an area of commerce that was not even recognised as existing under English law. However, John was gently insistent and understood the role that franchising would play in an increasingly global economy. For John, who was a true legal polymath (having authored several leading textbooks on areas of law as diverse as taxation and package holidays), the breadth and depth of legal knowledge that was required merely made franchising a more interesting and rewarding area of law in which to specialise.

Showing his characteristic altruism and desire to help young lawyers make the most of their talents, John guided and supported me as I struggled to understand the international complexities of franchising, sending me to the United States, where I was able to immerse myself in the dynamic and highly regulated world of American franchising. I also had the pleasure of co-authoring my first chapter in a legal text book on franchising with John, or 'JANJ', as the younger lawyers in the firm referred to him. In his typically gracious and humorous manner, he insisted that my name appear before his in the index and on the first page of the chapter as, in his words, "The 'A' is mightier than the 'N'!"

John was a charming and self-effacing individual, with a kind word for everyone and a genuine interest in everybody who worked with him. I was only one of his protégées, and he steered many other young lawyers to become internationally renowned practitioners in

a number of other areas of law, such as taxation and international travel. John took all of the hard work involved in supporting and shaping the careers of young lawyers easily in his stride, while at the same time successfully managing one of the City's up-and-coming law firms, looking after a large and demanding portfolio of blue-chip clients and making regular Saturday visits to Plough Lane, where he watched his local football club, Wimbledon (aka 'the Crazy Gang'), win the FA Cup in 1988 and then try to defy gravity by vainly battling to avoid relegation from the first division for the rest of the decade.

Thirty-five years on from the time that John introduced me to international franchising, his confidence in the future role and importance of franchising in the world economy has been vindicated. As usual, he was able to see what most others could not – potential, whether it was in respect of people or ways of doing business.

The Franchise Law Review is therefore just one small part of John's legacy to the legal profession and it is my great pleasure to dedicate this fourth edition to him.

Since the publication of the third edition of *The Franchise Law Review*, there have been major economic and geopolitical developments that have had a significant impact on world trade, not least the election of Donald Trump as president of the United States and the referendum that resulted in Brexit. The price of oil is still low, China's manufacturing sector is still suffering significant setbacks, Europe faces a further range of challenges, Iran and Saudi Arabia are exacerbating the problems in the Middle East and the Russian economy continues to float in the doldrums. Through all this, however, the apparently inexorable march towards the globalisation of commerce has continued unabated.

Despite the slow emergence of a few economic bright spots, the economy of what was once called the 'developed' world continues to struggle for the most part, while even Brazil (despite the recent Olympics) is still wallowing in recession. As a consequence, businesses are often presented with little choice but to look to more vibrant markets in Asia, the Middle East and Africa for their future growth.

The key word would seem to be uncertainty.

Brexit is set to have an impact on franchising in Europe, but it is as yet unclear what that impact will be. With the fall in the pound against the dollar we have already seen a number of US franchisors buy out their UK master franchisees. However, whether that is a long-term trend remains to be seen. In legal terms, the only potentially significant impact so far has been upon EU trademarks, resulting in many franchisors taking the precaution of also registering UK brands for their marks. On the other side of the Atlantic, the election of Donald Trump to the presidency is another unknown that will most probably have an impact upon franchising during the next few years.

The political uncertainty in continental Europe is also likely to have some impact. With the demise of both Hollande in France and Renzi in Italy, and the general rise of anti-establishment and anti-EU parties, Chancellor Merkel in Germany seems likely to be one of the few strands of continuity over the coming few years.

South–South trade continues to increase, perhaps at the expense of its North–South counterpart. All of this, coupled with the unstable wider geopolitical landscape, presents business with only one near certainty: there will be continued deleveraging of businesses in the coming years and, thus, growing barriers to international growth for many of them. All but the most substantial and well-structured of such businesses may find themselves facing not only significant difficulties because of their reduced access to funding for investment in their foreign ventures, but also challenges arising from their lack of managerial experience and bandwidth.

At the same time, the regulation of franchising continues to evolve and the past 12 months have seen the EU Parliament focus on how it might best change the regulatory environment for franchising within the European Single Market.

Despite all of the above uncertainty, franchising, in its various forms, continues to present businesses with one way of achieving profitable and successful international growth without the need for either substantial capital investment or a broad managerial infrastructure. In sectors as diverse as food and beverages, retail, hospitality, education, healthcare and financial services, it continues to be a popular catalyst for international commerce and makes a strong and effective contribution to world trade. We are even seeing governments turning to it as an effective strategy in the future development of the welfare state, as social franchising continues to gain traction as a means of achieving key social objectives.

Given the positive role that franchising can make in the world economy, it is important that legal practitioners have an appropriate understanding of how it is regulated around the globe. This book provides an introduction to the basic elements of international franchising and an overview of the way it is regulated in 36 jurisdictions.

As will be apparent from the chapters of this book, there continues to be no homogeneous approach to the regulation of franchising around the world. Some countries specifically regulate particular aspects of the franchising relationship. Of these, a number try to ensure an appropriate level of pre-contractual hygiene, while others focus instead on imposing mandatory terms upon the franchise relationship. Some do both. In certain countries, there is a requirement to register certain documents in a public register. Others restrict the manner in which third parties can be involved in helping franchisors meet potential franchisees. No two countries regulate franchising in the same way. Even those countries that have a well-developed regulatory environment seem unable to resist the temptation to continually develop and change their approaches to regulation – as is well illustrated by the recent changes to the Australian regulations. The inexorable onward march of franchise regulation continues, with countries such as Argentina – which previously had not specifically regulated franchising – adopting franchise-specific laws in the past 12 months.

Many countries do not have franchise-specific regulation, but nevertheless strictly regulate certain aspects of the franchise relationship through the complex interplay of more general legal concepts such as antitrust law, intellectual property rights and the doctrine of good faith. This heterogeneous approach to the regulation of franchising presents yet another barrier to the use of franchising as a catalyst for international growth.

This book certainly does not present readers with a full answer to all the questions they may have about franchising in all the countries covered – that would require far more pages than it is possible to include in this one volume. It does, however, in the first section, try to provide the reader with a high-level understanding of the challenges involved in international franchising, and then, in the second section, explain how these basic themes are reflected in the regulatory environment within each of the countries covered.

I should extend my thanks to all of those who have helped with the preparation of this book, in particular Caroline Flambard and Nick Green, who have invested a great deal of time and effort in making it a work of which all those involved can be proud.

It is hoped that this publication will prove to be a useful and often-consulted guide to all those involved in international franchising, but needless to say it is not a substitute for taking expert advice from practitioners qualified in the relevant jurisdiction.

Mark Abell

Bird & Bird LLP

London

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Chapter 42

PORTUGAL

*Magda Fernandes, José Maria Montenegro, Vasco Stilwell d'Andrade
and Filipa Correia da Silva¹*

I INTRODUCTION

The Portuguese Franchising Association and the Institute for Information in Franchising (IIF) were created to provide information about franchising and to help undertakings to overcome difficulties resulting from the lack of specific rules applicable to franchising. Both entities encourage contact between the various groups with an interest in franchising, whether franchisors, companies looking for business partners, franchisees, potential investors or suppliers of goods and services for networks.

The IIF monitors the development of franchising in Portugal through its franchising census, which it carries out regularly. According to the twentieth franchising census, in 2014, Portugal has verified clear growth in the franchise market, with a significant increase in the number of brands and the diversification of business areas. In 2014, 41 new business concepts were developed in the national franchise market, which now consists of 524 franchise brands (63.4 per cent of them from Portugal). After the Portuguese brands, the national franchise market in 2014 was dominated by Spanish brands, which represent 13 per cent of new networks, followed by brands from countries such as the United States, France, the United Kingdom, Italy and Brazil (14.6 per cent).

¹ Magda Fernandes is a partner, José Maria Montenegro is a senior lawyer, Vasco Stilwell d'Andrade is a senior associate and Filipa Correia da Silva is an associate at Morais Leitão, Galvão Teles, Soares da Silva & Associados. Parts of this chapter originally appeared in Dennis Campbell (ed.), *International Franchising* (Huntington, New York 11743: Juris Publishing, Inc, 2012).

II MARKET ENTRY

i Restrictions

Foreign investment is permitted in almost all economic sectors open to private investment in general, there being virtually no barriers to foreign-owned or foreign-directed enterprises.

Foreign investment operations do not need to be registered with, or authorised by, the Portuguese central or local authorities. Administrative requirements concern only specific matters such as trademarks, intellectual property rights and certain sector-specific regulation. However, for EU-based investors such requirements cannot constitute restrictions to the right of establishment set out in the Treaty on the Functioning of the European Union (TFEU).

In addition, the Portuguese government may grant benefits to large investment projects – to both national and foreign investors – such as financial incentives and tax benefits or public funding. AICEP Portugal Global is the government business entity entrusted to manage and attract foreign investment, and it is entitled, on behalf of Portugal, to receive, assess, negotiate and contract large investment projects eligible to benefit from state aid. Nevertheless, as member of the EU, the Portuguese government must comply with state aid rules established in the TFEU; thus, the award of such benefits may require prior approval by the European Commission.

ii Foreign exchange and tax

Corporate income tax (IRC) is applicable to income obtained both by resident and non-resident entities. Portuguese law taxes non-resident entities only on the income obtained in Portugal, and taxes resident entities on global income, either from internal or external sources.

Resident entities are normally taxed on the basis of the relevant periodic tax return on their global income. Non-resident entities may be taxed either by means of a definitive withholding tax or, in some situations (i.e., capital gains), are required to submit a periodic tax return on income. For non-residents, the following rates are applicable:

- a* capital gains, 25 per cent;
- b* dividends, 25 per cent;²
- c* interest, 25 per cent;³
- d* royalties, 25 per cent;⁴
- e* other services, 25 per cent, except for transport, communications and financial services;⁵ and
- f* investment income (including dividends, interest and royalties) paid to an entity domiciled in a tax haven listed in the Portuguese blacklist of offshore jurisdictions is taxed at 35 per cent.

Portugal has signed double-taxation treaties with 68 countries and nine are pending ratification.

2 This tax rate may, however, be reduced, to as little as 5 per cent, according to double-taxation treaties.

3 This tax rate may, however, be reduced, to as little as 5 per cent, according to double-taxation treaties, and under Directive 2003/49/CE payments to qualifying EU recipients are exempt.

4 See footnote 3.

5 This tax may be reduced or eliminated according to double-taxation treaties.

III INTELLECTUAL PROPERTY

i Brand search

There are currently millions of registered trademarks in the world and several hundred thousand of them are in force in Portugal. Determining the ability to use a trademark in the Portuguese market is essential before large investments are made in marketing and packaging.

Registered trademarks can be searched in a number of public databases or, alternatively, it is possible to hire specialised companies to conduct in-depth clearance searches. Two of the most popular public databases used in Portugal are TMview and the database of the National Institute of Industrial Property (INPI).

In performing a trademark clearance search, it is necessary to bear in mind the criteria used for assessing the likelihood of confusion, namely issues of priority, similarity of goods and services and similarity of the marks from visual and phonetic perspectives. One should remember that no search provides a 100 per cent guarantee that the trademark application will proceed to grant nor that there will be no third-party opposition.

Indeed, in assessing the viability of a trademark application, it is important to remember that, *inter alia*, company names may be used as basis for opposition and that foreign trademarks often benefit from a six-month priority period, during which they can claim protection in Portugal. Unregistered trademarks that are used in commerce also have limited protection for an initial period of six months.

Furthermore, given that Portugal is a Member State of the Madrid Agreement and Protocol and of the EU, it is necessary to remember that Community and international trademarks may also be in force in Portugal.

Whereas the process of searching and clearing a trademark is a well-understood and common procedure, verifying the non-existence of conflict in other areas (image rights, business process, etc.) is highly complex and carries with it significantly more risk. These risks should be duly taken into consideration in franchise agreements.

ii Brand protection

The relevant authority for registering Portuguese trademarks or patents is the INPI. The request to register a trademark is filed and subsequently published in the official Industrial Property Bulletin. There is a two-month period in which the application may be challenged by any interested party. The applicant has a further two months in which to contest the challenge, as provided by Article 17 of the Industrial Property Code.

INPI will only start examining the application after the two or four-month period referred to above; the purpose of the examination being to ascertain and confirm whether the application meets the criteria foreseen in the law, namely that the trademark is not likely to be confused with an already existing registered trademark. The application is only approved following this examination, after which it is registered and published in the official Industrial Property Bulletin. These decisions can be appealed to the Intellectual Property Court, currently seated in Lisbon, or, if all interested parties agree, to an arbitral court set up at the ARBITRARE centre.

Decree-Law No. 125/2006 of 29 June 2006 created the 'on-the-spot trademark' regime, according to which it is possible to buy a pre-approved trademark equivalent to the company name chosen at the same time that an 'on-the-spot company' is incorporated.⁶

Article 316 of the Industrial Property Code establishes that industrial property benefits from the same protections as those established for property in general. An owner of a registered trademark may file a claim against anyone infringing the owner's trademark rights, namely using, without authorisation, in the course of trade, a mark that is identical or similar to the one registered, on products and services identical or similar to those included in the aforementioned registration and, as a consequence, causing a risk of confusion in the market.

Special protection exists in Portugal for well-known or prestigious marks. An owner of an unregistered trademark also may file a claim under the unfair competition chapter of the Industrial Property Code or under the general rules of non-contractual or contractual liability set forth in the Civil Code.

Article 317 of the Industrial Property Code establishes that certain behaviour by competitors may be considered unfair competition, including any acts that mislead consumers as to the identity of the company and origin of the products or services.

Furthermore, Article 318 establishes that the unlawful acquisition, disclosure or use of a competitor's trade secrets is considered illegal.

As with Portuguese trademarks, which are registered in a manner almost identical to that seen in other European Union countries, other intellectual property rights such as patents and designs also follow approval procedures closely based on EU legislation or international treaties.

iii Enforcement

The types of action available to a foreign trademark holder will largely depend on the circumstances of such a trademark being registered or in force in Portugal. If the trademark is in force in Portugal, the foreign trademark holder may file a civil trademark infringement proceeding against the infringer, requesting that the infringement cease and, additionally, requesting compensation in cases where damage has occurred. In situations of great urgency, it is possible to file a preliminary injunction for the cessation of the infringing activity.

The foreign trademark holder may instead or in addition file a criminal complaint against the infringer, given that trademark infringement constitutes a crime under Portuguese law. Such a complaint would be investigated by the Portuguese public prosecutor and it is for the latter to decide to bring a case to court. The plaintiff also can request compensation under this procedure. The criminal complaint would have to be filed by the trademark owner within six months of him or her becoming aware of the infringing actions.

Furthermore, a foreign trademark holder may file a complaint of unfair competition, which is considered a misdemeanour under the Industrial Property Code. The complaint is filed with the Economic and Food Safety Authority, a police agency, and it is then decided by

⁶ Decree-Law No. 318/2007 of 26 September 2007 established the possibility of obtaining an on-the-spot trademark independently of the incorporation of a company. All the relevant administrative services start and finish the procedural formalities on the same day, and just one personal visit is required. A registered trademark also can be bought online, via a public-access website.

the INPI. In the context of franchise agreements, the improper use of a trademark generally gives rise to a breach of contract, the consequences of which are typically resolved by either a judicial court action or arbitration (depending on what is stipulated in the agreement).

iv Data protection, cybercrime, social media and e-commerce

Personal data is often a vital component of a franchise agreement. Indeed, customer lists and supplier contacts are often valued information that the franchisee wishes to access when entering into a franchise agreement.

The importance of personal data protection has been growing considerably in Europe and, naturally, also in Portugal. Great care should be taken to ensure that personal data are collected in a legal manner and that any transfers of personal data (particularly across borders) are done lawfully. Direct marketing is also tightly regulated and it is necessary to ensure that the legal criteria for sending marketing materials are in place. The main law regulating personal data processing in Portugal is Law No. 67/1998 of 26 October.

Another important aspect of franchising deals is the access to common IT systems or databases. This access should be regulated since unlawful access to these IT systems may constitute a crime. Law No. 109/2009 of 15 September approved the Cybercrime Law, transposing into Portuguese law Council Framework Decision 2005/222/JHA of 24 February on attacks against information systems, and it has also adapted Portuguese law to the Council of Europe Convention on Cybercrime. Pursuant to Law No. 109/2009 of 15 September, several software infringements are punishable as criminal offences. These include, by way of example, computer sabotage and unlawful hacking or unlawful copying of a protected program. Companies and any equivalent legal entities may be held liable for the crimes established in this legislation.

The protection of software and the general consequences for software infringement are foreseen in the Copyright and Neighbouring Rights Code (as amended) and also in Law-Decree No. 252/94 of 20 October (as amended). E-commerce is regulated in Portugal primarily under Law-Decree No. 7/2004 of 7 January (as amended).

IV FRANCHISE LAW

i Legislation

In the area of commercial distribution, only agency agreements are specifically regulated. Neither distribution nor franchise agreements are the subject of specific legislation in Portugal, even though certain legal provisions are especially relevant to franchise agreements. Considering the lack of a specific legal regime applicable to franchise agreements, no licence is required for franchise salespersons.

In the absence of imperative legal provisions, the parties are free to determine their own governing rules and clauses as long as these are consistent with generally applicable contractual principles.⁷ In particular, when interpreting and applying contractual rules, Portuguese courts will give due consideration to pre-contractual liability principles that require parties to act in good faith during negotiations.

7 The principle of freedom of contract is generally established in the Civil Code, Article 41/2.

ii Pre-contractual disclosure

Portuguese courts have often decided in this area that parties are required to provide all necessary information prior to execution of a franchise agreement, failing which statutory civil liability may arise under Portuguese law, in particular under Article 227 of the Civil Code. Notwithstanding the fact that there is no specific legislation applicable to franchising, general rules of trademark law, company law, product liability law, standard contract terms law, agency law, employment law and consumer protection law are fully applicable to franchise agreements. Franchising is also subject to national and EU competition rules.

General contractual principles prohibit the use of false and misleading expressions concerning one's own business operations or those of another party that are of a character tending to affect the supply of, or demand for, a commodity. These principles also may be regarded as applying to franchise agreement negotiations (i.e., the franchisor must provide an accurate description of its operations). If a franchisor infringes this requirement and gives a prospective franchisee an untrue or misleading impression, this may constitute grounds for rescinding or terminating the entire agreement based on pre-contractual liability established in the Civil Code.

iii Registration

Apart from the acquisition of a Portuguese company, establishing a company or a branch is the most common method of business organisation employed in Portugal. The most common types of company in Portugal are the limited liability company (SA) and the limited liability partnership (SQ), which have in common the fact that shareholders' liability is generally limited to their interest in the capital share of the company.

Although less often used, there are other ways of investing in Portugal (e.g., through joint ventures and partnerships). A franchisor may directly license franchisees where it is not necessary to control or supervise franchisees' activity in depth. This has the advantage of reducing the franchisor's set-up costs in the franchisee's location.

A limited liability company is, in principle, required to have at least five shareholders, but a single shareholder is allowed when such a shareholder is itself an SA. Registration with fiscal and commercial registry authorities is required for such a company.

The minimum capital share is €50,000, which may be paid in cash or in kind. An SQ tends to be used for smaller investments, with no capital share minimum required by law. A minimum of two shareholders is required, although it also is possible to set up an SQ with only one shareholder, which is designated as a Sociedade Unipessoal por Quotas, or SUQ. Registration with the commercial registry and fiscal authorities is also required for such a partnership.

iv Mandatory clauses

Imperative rules and essential principles of Portuguese law are mandatory and thus also applicable. Franchising operations in Portugal are also bound by directly applicable EU legislation governing franchising.

v Guarantees and protection

In franchise agreements drafted in Portugal, the shareholders of the corporate franchisee often guarantee its obligations, by bank guarantee or, alternatively, by personal guarantee secured against particular assets of the guarantor or against all of the guarantor's assets.

Article 6 of the Industrial Property Code establishes that the rights from patents and utility models, as well as designs or models and other trademarks, are subject to seizure and attachment and can be pledged or subject to other seizure of property.

A lender may seek a collateral assignment of the franchise agreement itself that enables the lender to succeed in the rights and interests of the franchisee upon the loan's default.

To avoid such a result, franchisors should object to the use of collateral assignments, whether by generally forbidding such an assignment of the franchise agreement, or by imposing specific conditions on such an assignment. The franchisor may not be left in a position where the lender continues to run the franchisee's business.

Therefore, it is useful to include in the franchise agreement clauses providing for the prohibition of the assignment of rights without the prior consent of the franchisor.

V TAX

i Franchisor and franchisee tax liabilities

In Portugal there is no specific tax legislation regarding franchising contracts and relations between franchisors, franchisees and other parties who may be involved. The general tax system, therefore, is applicable in respect of franchisor and franchisee liabilities.

As franchisor and franchisee could opt to act on an individual or a corporate basis, it is important to summarise the most common and relevant taxes of the Portuguese tax system.

Tax on corporations

Company profits are subject to IRC, which is supplemented by a municipal surtax levied on the IRC by some municipalities, and by a state surtax.

IRC is levied on all corporate bodies resident in Portugal or that have a permanent establishment in Portugal. Moreover, non-residents that obtain income in Portuguese territory also are subject to IRC (see Section II.ii, *supra*). To qualify as a resident, a company or other entity must have its seat or its place of effective management in Portugal. Any corporate body or other entity that does not have its legal seat and place of effective management in Portugal is treated as a non-resident company for IRC purposes (including offshore companies). Non-resident companies that have a permanent establishment in Portugal are liable to IRC and state and municipal surtaxes with respect to income and gains attributable to the permanent establishment. Portuguese subsidiaries of non-resident corporate entities are resident legal entities for tax purposes, being taxed on their worldwide taxable income in the same way as any other Portuguese-resident legal entity.

The taxable base is made up of the net profit for the year plus certain changes in equity not included in the net profit, less tax benefits and allowable losses, or credits related to financial costs, from previous years. The general rule on business expenses is that a deduction is allowed for all expenses incurred for the purpose of generating or guaranteeing the taxable income. To be deductible, expenses must be substantiated.

Capital gains realised by resident companies, including Portuguese permanent establishments of non-resident companies, are generally included in taxable profits and are taxed at the normal rate. Capital gains include both voluntary capital gains (i.e., gains realised from the sale or exchange of fixed assets or the appropriation of a company's fixed assets for any purpose unrelated to the operation of the business) and involuntary capital gains (i.e., gains realised on compensation for expropriation and on indemnification for a disaster or theft). Fifty per cent of the capital gains from tangible fixed assets, intangible assets and

biological assets (which are not consumable) held for more than one year are exempt from tax if the total consideration received is reinvested the year before or within two years of such a disposal in the purchase, manufacture, or construction of other tangible fixed assets, intangible assets, or biological assets (which are not consumable), provided that they are not purchased from entities with which a special relationship exists.

Moreover, full capital gains exemption applies to gains derived from the sale of shares in the capital of a company if held uninterruptedly for a minimum period of 12 months, provided the taxpayer owns at least 10 per cent of the share capital or voting rights of the company and does not reside in a blacklisted jurisdiction and is subject to corporate income tax.

Tax losses can be offset against tax profits of the next five periods or, for companies that carry on primarily an activity of a commercial, industrial or agricultural nature, of the next 12 years (special rules apply to tax losses deduction for companies under a tax group special regime or in the event of business reorganisations).

The general IRC rate for resident companies and Portuguese permanent establishments of non-resident companies is 21 per cent for taxable amounts exceeding €15,000 and 15 per cent for taxable amounts under that value. A municipal surtax of 1.5 per cent is levied on taxable profit prior to the deduction of carry-forward tax losses in certain municipalities. A state surtax also applies prior to the deduction of available carry-forward tax losses at the following rates: 3 per cent applicable to taxable profit above €1.5 million up to €7.5 million; 5 per cent applicable to taxable profit above €7.5 million up to €35 million; 7 per cent applicable to taxable profit above €35 million.

Tax on individuals

Individuals are subject to personal income tax (IRS) levied at a national level throughout the Portuguese territory. Other taxes imposed on individuals are a 10 per cent stamp duty on inheritance (although transfers in favour of spouses, descendants, and ascendants are tax exempt) or gifts, and the annual municipal real estate tax. Resident employees and self-employed individuals are required to pay social security contributions.

The tax rates applicable to aggregate net results in 2016 are progressive (from 14.5 per cent – for results above €7,035 – up to 48 per cent – for results above €80,000).⁸ Moreover, a temporary additional income tax rate applies at the following rates: 2.5 per cent on the part of the taxable income exceeding €80,000; 5 per cent on the part of the taxable income exceeding €250,000.

Value added tax

Value added tax (VAT) is regulated by the Portuguese VAT Code introduced to bring domestic legislation into line with the Sixth VAT Directive⁹ and subsequently with the recast VAT Directive.¹⁰

8 Resident individuals must include 50 per cent of the gross domestic dividends received in their taxable income for progressive income tax purposes (partial imputation system).

9 Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes.

10 Directive 2006/112/EC on the common system of value added tax.

VAT is an indirect tax on the consumption of goods and services and is normally paid by the final consumer. VAT also applies to the importation of goods by any person, although a taxable person may be able to treat VAT as an input tax and offset it against the output tax payable on any subsequent supply of those goods.

The standard VAT rate in Portugal is 23 per cent (the standard VAT rate in Madeira and the Azores is 22 and 18 per cent, respectively). In addition, an intermediate rate of 13 per cent and a reduced rate of 6 per cent are currently applicable to a range of goods and services (in the Azores the intermediate and reduced rates are levied at 10 per cent and 5 per cent, while in Madeira these two rates are levied at 12 per cent and 5 per cent respectively on the same supplies).

In general terms, any person who independently carries out any economic activity in any place, whatever the purpose or results of that activity – including all the activities related to franchising agreements – is taxable for VAT purposes. According to the Portuguese VAT Code, any individual or corporate entrepreneur subject to IRC or IRS on their business or professional activities is also a VAT taxable person. Additionally, such entities (franchisor or franchisee) are also taxable persons for VAT purposes whenever they acquire intra-Community goods and services from a VAT taxable person with no headquarters, permanent establishment, or domicile in Portuguese territory and that has not appointed a tax representative in Portugal.

VAT liability is incurred on supplies of goods and services by an entrepreneur within the Portuguese territory in the course of his or her business enterprise or during the exercise of his or her professional practice or artistic activity. The importation of goods into Portugal by any person incurs VAT liability. Importation is in itself a taxable event and is liable to VAT regardless of whether or not the importer of the goods is an entrepreneur.

Intra-Community acquisitions of goods and services by a taxable person are liable to incur VAT.

Regarding the common franchising agreements, the distinction between services rendered and supplies of goods could be relevant in determining the location of the operation for VAT purposes. However, some current activities (intellectual property rights, technical assistance, general assistance services) are considered as services for that purpose.

Both residents and non-residents without a permanent establishment in Portugal are subject to some formal procedures related to VAT payment and compliance liabilities.

Customs regulation and excise taxes

On joining the EU in 1986, Portugal adopted the EU common customs tariff, which required the removal of all tariff and non-tariff barriers with other Member States and the setting up of the common customs tariff uniformly applied in the European Economic Community (EEC). Portugal also adopted Commission Regulation (EEC) No. 2454/93 of 2 July 1993, which laid down provisions for the implementation of the Regulation establishing the Community Customs Code. The implementation of the internal Community markets led to free movement within the EU territory of manufactured tobacco, alcohol, alcoholic beverages and petroleum, although these products are subject to excise taxes. The EU harmonisation of legal provisions concerning the holding, movement and control of products subject to excise taxes has led to the establishment in Portuguese law of the juridical-fiscal notion of ‘fiscal warehouse’ to be applied to any place where the taxable products are produced, processed,

held, received or dispatched by the authorised depositary in the exercise of his or her activity, under the excise tax procedure scheme and according to the conditions established in the Portuguese Excise Taxes Code.

Products will be chargeable to tax from the point of production or importation into the domestic territory or the territory of another Member State, provided that, in the latter case, they are dispatched into the domestic territory.

Also subject to tax in the domestic territory are those products that have already entered into consumption channels in another Member State and that are purchased for one's own consumption or for commercial purposes. The circulation of such products between the territory of other Member States and the domestic territory will be subject to an accompanying document.

Liability to tax will occur within the domestic territory upon entry into consumption channels or on verification of missing products that should be taxed.

Local taxes

The main local taxes – which should also apply to the parties in a common franchising agreement – are the municipal tax on real estate, municipal tax on real estate transfer and municipal vehicle tax.

ii Tax-efficient structures

For tax purposes, as mentioned, there is no specific tax legislation regarding franchising contracts and relations between franchisors, franchisees and other parties who may be involved.

The tax incentives regimes, therefore, are totally applicable to franchising investments, provided they comply with the requirements.

Investment incentives

Incentives for investments in less developed regions

An incentive programme is available to qualifying companies, such as those involved in agriculture, fisheries, the coal industry or tourism, for the setting up of operations in listed, less developed areas in mainland Portugal. To qualify for the incentives, a company must, *inter alia*, create net permanent jobs attached to the underlying investment and not be deemed to be in 'financial difficulties'.¹¹ The incentive programme includes a corporate tax deduction of 25 per cent of capital expenditures up to €5 million and 10 per cent of capital expenditure over that amount in investment conducted in areas where the standard of living is abnormally low or where there is serious underemployment.

Also included in the incentive programme is an annual real estate tax exemption or reduction related to immoveable property held within the scope of the investment for a period of up to 10 years, a real estate transfer tax exemption or reduction and a stamp duty exemption on all immoveable property acquisitions that constitute capital expenditure.

Contractual tax incentive

Contractual tax incentives are granted for industrial investment projects carried out before 31 December 2020 if they involve an investment of at least €3 million and are deemed to

11 As defined in the Commission communication published in the Official Journal of the European Union No. C 249, of 31 July 2014.

be of strategic interest to the domestic economy and encourage job creation, technological innovation, and domestic scientific research. The incentives, granted by the central government on a case-by-case basis for a maximum period of 10 years, include a 10 per cent to 25 per cent investment tax credit and an exemption.

Incentive scheme for Madeira and Azores free zones

Portugal has two free trade zones (International Business Centres): Madeira and Santa Maria (Azores). Under the state-aid rules of the EU, Portugal was authorised to enact a socio-economic programme aimed at overcoming the structural underdevelopment of the autonomous regions of the Azores and Madeira.

Qualifying industrial, shipping and international services, and financial entities licensed to operate in the Madeira free trade zone or within the Santa Maria Island (Azores) free trade zone are eligible for specific tax exemptions and low taxation.

Patent Box

In the context of the corporate tax reform that came into force in 2014, a Patent Box regime was created for certain industrial property rights, such as patents, designs and registered industrial models. According to the regime only 50 percent of income arising from the temporary assignment or use of the rights is taxable, while costs are fully deductible.

VI IMPACT OF GENERAL LAW

i Good faith and guarantees

Because of the lack of specific law applicable to franchise agreements, the means of protection available to the franchisee are those established by general statutory regimes. Therefore, rules on the freedom to contract,¹² principles of good faith¹³ and public order should generally apply to franchise agreements.

ii Agency distributor model

In the absence of particular law applicable to franchising, courts and doctrine have widely considered that the agency regime should be applicable to franchise agreements in relation to termination of the contract.¹⁴

iii Employment law

Franchising contracts clearly state that the franchisee is legally independent from the franchisor and that, consequently, the franchisor cannot be held liable for actions or omissions of the franchisee.

Employees may hold only their employers liable, which means they cannot sue the franchisor for actions or omissions of the franchisee.

12 Civil Code, Article 405.

13 Civil Code, Articles 227, 334, and 762.

14 Decree Law No. 178/86 of 3 July 1986, as amended (the Agency Law).

iv Consumer protection

Because of the lack of specific law applicable to franchise agreements, franchisees have commonly made recourse to the protection available under the Agency Law (i.e., as to the rights applicable to the franchisee upon termination of a franchise agreement). In addition, Portuguese courts have provided that unreasonable, abusive or unfair clauses, or entire contracts may be modified or be declared null and void. This may happen when the contract has not been negotiated but rather presented by the franchisor to the franchisee as a standard form.

The Law of General Contractual Clauses¹⁵ applies to all contracts that include general conditions (i.e., clauses not subject to negotiation). Thus, a franchisor presenting the franchisee with an agreement containing general conditions that are not expressly negotiated between them may be caught by the Law of General Contractual Clauses.

The Law of General Contractual Clauses sets out a number of items that are not permitted under national law and others that must be included or expressed within the agreement. For example, an agreement cannot exclude the right to damages or include penalty provisions for defaults that are disproportionate to the damage or loss suffered.¹⁶ As indicated above, these types of clause may be deemed unreasonable and modified or rejected by Portuguese courts. Furthermore, such general provisions in franchise agreements may be caught by competition law, in particular rules on the abuse of economic dominance.

Finally, other general aspects of Portuguese civil law may be applicable, such as that relating to usury, which considers null any contract under which a party takes advantage of the other party's inexperience, weakness or dependency.¹⁷

v Competition law

Franchise agreements often contain restrictions to competition (e.g., exclusivity, selectivity and non-compete clauses) that may raise issues under competition law. Breach of national competition law results in the nullity of the agreement (or the anticompetitive clauses), in addition to potential imposition of fines on the parties in the agreement pursuant to antitrust proceedings conducted by the Portuguese Competition Authority.

From a competition point of view, there are no major substantive differences between national and European law applicable to franchise agreements and to its specific contractual provisions, such as price- and quantity-fixing, territorial and customer provisions, exclusive dealing, tie-in and other restrictive clauses.

In principle, territorial restrictions are banned by Article 9(1) of the Competition Act, which prohibits the division of markets and supply sources, as well as other anticompetitive conduct such as price-fixing and limiting production and technical development of investment.

Although clauses may be justified when the conditions set out in Article 10 are fulfilled, prohibition of parallel imports, passive sales or the ban of cross-supplies between distributors are considered to eliminate intra-brand competition and, therefore, do not fulfil the exemption conditions.

Resale price maintenance provisions, which are commonly used under franchise agreements, may also be caught under Article 9 of the Competition Act, especially since

15 Decree-Law No. 446 of 25 March 1985.

16 Law of General Contractual Clauses, Articles 18 and 19.

17 Civil Code, Article 282.

the article prohibits any agreement, concerted decision or practice whose effect is directly or indirectly to set prices or to interfere in price determination, whether to increase or decrease them.

vi Restrictive covenants

It is common in franchise agreements to include a restriction that prevents the franchisee from developing a similar or competitive business during the agreement and for a certain period after its termination. The validity of such clauses is not, in general, contested in Portuguese courts, as long as the clauses do not entail a violation of competition rules.

According to the Agency Law, the principal may establish a clause of non-competition to last a maximum of two years after termination, limited to the area in which the contract has been executed, but such a clause will entail a right of indemnity for the non-competition covenant.¹⁸ The clause also should provide for payment of a non-compete indemnity.

vii Termination

In general terms, franchise agreements contain a clause specifying the circumstances in which such an agreement may be terminated before the contract term, which will normally include events such as insolvency proceedings, failure to meet payment obligations, criminal convictions or a relevant breach of contractual obligations set forth in the franchise agreement.

In the event of a breach of contract, termination is permitted without a right to an indemnity beyond general contractual principles of damages for losses and what has been contractually agreed between the parties.

Some legal commentators have, however, argued that the rules on termination of agency agreements should apply to franchise agreements, arguing that the goodwill indemnity payment due to the agent on termination of the contract is also due under the same conditions (where new clients or business has been generated) on termination of a franchise agreement.¹⁹

There is some case law to support this view in other EU countries; however, Portuguese courts have generally rejected it. The view taken by the courts has been that the franchisee is generally participating in an existing organisation, thereby benefiting from an established client base or following its name, brand, know-how, methods and marketing, and should not be entitled to a goodwill indemnity on termination.

18 The Agency Law, Articles 9 and 13(g).

19 Several court decisions have held that, in the event of termination, prior notice given by the franchisor to the franchisee to terminate the franchise agreement should be similar to that established in agency law (decisions of the Appeal Court of Lisbon, of 18 May 2004, Case Number 3589/2004-7, and of 2 February 2006, Case Number 9219/2004-6). However, other court decisions have held that adequacy of prior notice should be determined on a case-by-case basis, so that agency law provisions may not be applied as such (decision of the Appeal Court of Lisbon, of 25 March 2004, Case Number 497-2004-2). The Supreme Court of Justice ruled, on 9 January 2007, Case Number 06 A 4416, that, in a franchise agreement, the loss of clientele is subject to indemnity only when the franchisee shows that it has contributed in a significant way to an increase in the number of the clients of the franchisor.

As regards the consequences of termination, the franchise agreement will normally establish that, upon termination, the franchisee will no longer be entitled to use the licensed trademarks or other intellectual property rights and will be obliged to immediately return all manuals and other confidential documents provided by the franchisor.

Regarding expiration of the agreement, it is a matter left for the parties to agree upon. Portuguese doctrine and case law have, however, been of the understanding that the length of the franchise agreement should be enough to enable the franchisee to recover its investments. Furthermore, there are a substantial number of court decisions, based on the principle of good faith and cooperation, that have established a right of indemnity for the franchisee when a franchisor has not given a reasonable notice period prior to the termination of contracts of undetermined length. Competition rules may also be of importance in this matter, in particular Article 7 of the Competition Act (Law No. 19/2012 of 8 May 2012), which establishes the prohibition of abuse of economic dependence in cases of unjustifiable termination of the agreement.

viii Anti-corruption and anti-terrorism regulation

In 2008, Law No. 25/2008 of 5 June was enacted establishing measures to combat money laundering and the financing of terrorism, transposing into Portuguese law Directive 2005/60/EC of the European Parliament and the Council of 26 October and Commission Directive 2006/70/EC of 1 August on the prevention of the use of the financial system, and of activities and specially designated professions, for the purpose of money laundering and terrorist financing.

In Portuguese law, money laundering is a criminal offence (Article 368-A of the Portuguese Penal Code), as is terrorist financing by virtue of the provisions laid down in Article 5-A of Law No. 52/2003 of 22 August (as amended by Article 62 of Law No. 25/2008 of 25 June).

ix Dispute resolution

In practice, a franchise agreement will determine the party's choice of law and jurisdiction, which will govern the rights and obligations of the parties and settle any disputes that arise out of or in connection with the franchise agreement. Portuguese civil law establishes that parties are free to agree on the jurisdiction that will decide on their disputes. According to the Civil Code,²⁰ choice of jurisdiction must be contained in a written jurisdiction clause and the following cumulative prerequisites should be met:

- a* the election of a given jurisdiction must relate to a dispute over available rights;
- b* it must be accepted by the law of the designated court;
- c* it must be justified by a serious interest of both parties or one of them, as long as it does not involve major inconvenience to the other;
- d* it may not fall under the exclusive competence of Portuguese courts; and
- e* it should be contained in a written agreement or confirmed in writing, making explicit mention of the competent jurisdiction.

20 Civil Code, Article 99.

EU Council Regulation (EC) No. 44/2001²¹ will also be applicable if one of the parties in the contract is domiciled in a contracting state. Often, a franchise agreement will provide for mediation or arbitration as an alternative method of resolving the dispute, since it provides a greater flexibility and expertise. Furthermore, according to civil internal rules, Regulation (EC) No. 44/2001 and the 1958 Rome Convention, Portuguese courts will enforce a foreign judgment or foreign arbitral award.

As long as mandatory arbitration national rules are respected, foreign arbitral awards will be recognised by the Portuguese courts.

VII CURRENT DEVELOPMENTS

According to the conclusions of the twentieth annual IIF franchise census, franchising was responsible for the creation of around 63,670 jobs in Portugal, about 1.4 per cent of employment generated in 2014.

By sectors, trade was the dominant sector, going from 25 per cent in 2013 to 43.9 per cent in 2014 and becoming the most important segment in the national franchising market. Services (41.5 per cent) and restaurants and the hotel industry (14.6 per cent) are the other sectors that attained a place on the podium in 2014.

According to the IIF franchise census, in 2014 there was 'greater diversification of business areas, with, however, some that stand out, such as food distribution, self-service laundries and perfumeries, among others, but [those sectors] do not take a dominant position as happened in the recent past with beauty products or the purchase and sale of gold'.

21 Council Regulation (EC) 44/2001 of 22 December 2000.

Appendix 1

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Magda Fernandes, partner, joined MLGTS in 2007. She is a member of the litigation and arbitration team. Before she joined the firm, she worked in the areas of civil and commercial litigation and arbitration. She represents domestic and foreign clients with a particular focus on construction, technology, infrastructure, consumer law, media and advertising, distribution, agency and international franchises. She also has experience in corporate and maritime law.

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Since 2010, José Maria has been an invited professor at the Polytechnic Institute of Porto, teaching the courses Tax Law I, Tax Law II and Legal Simulation. Before joining the firm, he worked with a multinational consultancy company and a national law firm in the tax field.

Between 2003 and 2004 José Maria Montenegro served as legal counsellor to the Minister of Justice in the XV Constitutional Government.

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Vasco Stilwell d'Andrade joined the firm in September 2008. Vasco works mainly in the intellectual property field, namely in protection strategy and implementation, licensing, assignments, valuation and litigation, frequently assisting in litigation matters involving

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