Current Laws Governing Franchise Agreement in Jordan

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Received: December 7, 2015   Accepted: February 25, 2016   Online Published: March 18, 2016
doi:10.5539/ass.v12n4p45          URL: http://dx.doi.org/10.5539/ass.v12n4p45

Abstract

Currently there are more than 150 local and international franchise businesses operating in Jordan. Franchise business in Jordan has been a crucial investment market contributing to the country’s Gross Domestic Product (GDP) and developing its economic growth and trade. Nevertheless, legal challenges to the investors which have existed may hinder them from opening up a franchise business in Jordan. One of these challenges is the lack of specific legal framework regulating franchise business. Jordanian legal system does not have specific legislation to regulate the franchise agreement (which is known as the “license agreement” in Jordan) between a franchisor and a franchisee. The lack of specific legislation may deter or at least slow down the progress of foreign and local investors in setting up franchise businesses in Jordan, as they could not reasonably anticipate the relevant laws and regulatory enforcements relating to franchise. Therefore, this paper examines the current laws and regulations governing franchise business in Jordan. The paper concludes that existing laws affecting franchise in Jordan fail to address comprehensively the legal aspects of franchise. Thus, there is a dire need for specific legal framework to govern franchise business in Jordan.

Keywords: franchise business, specific legal framework, Jordanian laws, franchise agreement

1. Introduction

Jordan is a country located in the Middle East, with a size slightly smaller than the state of Indiana, in the U.S. It borders Saudi Arabia, Israel and Iraq, occupies a total of 89,342 square kilometers and contains a total population of 6.5 million with a 0.14% growth rate. Amman, the capital city of Jordan has a population of 1.08 million people that are predominantly Muslims (Sharp, 2014). Jordan is ruled by a constitutional monarchy and its official language is Arabic, with English extensively spoken among the upper and middle classes. The Jordanian currency is the Jordanian Dinar and Jordan is known for being a tourist destination, with its moderate climate and historical sites including the Dead Sea, Petra and Wadi Rum (Prados, 2002). As a result, various types of businesses have been established in Jordan, including the franchise.

Franchise business has been introduced into Jordan in the 1980s, and presently more than 150 franchise businesses are operating in the country. In fact, the franchise industry provides direct employment for 12,000 people and boasts annual sales of U.S.$100 million. In the context of franchises, the local market embraces U.S. franchises (Jones, 2003), where local investors are increasingly paying great attention to franchise, particularly in the service and fast food industry (International Franchise Association [IFA], 2015). The U.S. retail and service franchises have increased exponentially in the past years. Recent franchises in Jordan are TGI Fridays, Applebees, ACE Hardware and Ruby Tuesdays and in the food industry, franchises include KFC, Pizza Hut and McDonalds.

Other categories of franchises cover child care/development like FasTracKids, which is increasingly becoming popular. Moreover, several shopping malls have been recently launched in the capital in the past few years, which incorporated more new franchises, with others still under construction. This includes plans for establishing outlet stores in Amman’s southern suburbs. These plans are expected to produce greater opportunities for future retail franchises (IFA, 2015).

On the basis of the International Franchise Association, Jordan is attractive for business interests and in the second year of the Arab Spring, it showed its versatility in being a more attractive nation for investment and a
thriving market (IFA, 2015). In addition, Jordan has well-maintained cooperative relationship with its neighboring countries and the wider international business community.

Suffice to say that franchise in Jordan is a crucial investment approach that contributes to the country’s Gross Domestic Product (GDP) and helps in developing its economic growth and trade. It also allows better planning and maintains foreign investments. Additionally, several legislations have been passed that specifically addresses investments, industries and trades namely the Industry and Trade Act (No 18, 1988), the Companies Act (No 22, 1997) and the Trademark Act (No 34, 1999), the Intellectual Property Act (No 32, 1999) and the Unfair Competition and Trade Secret Act (No 15, 2000). Jordan’s legal system was adopted from the Ottoman and Egyptian legal systems and Sharia. The Jordanian legal system has also been influenced by the country’s tribal traditions (Office of King Hussein I, 2015).

Nevertheless, legal challenges to the investors may hinder them from opening up a franchise business in Jordan. One of the main challenges is the lack of specific legal framework to regulate franchise, where the rights and duties of the franchise parties and remedies available are still ambiguous. This has motivated the authors to examine the laws and regulations in relating to franchise agreement in Jordan in this paper.

2. Franchise Agreement

The following discussion will focus on the definition of franchise agreement. The discussion will also include the franchise concept to identify the franchise business, which is subject of the franchise agreement, due to the similarities with other business forms. In addition, the following discussion will include regulating franchising.

2.1 Definition

There are countries that do not have specific definition when it comes to franchise contract, such as Jordan. However, the general terms used to identify the franchise agreement in Jordanian law are slightly different from that in common law country. Franchise agreement is not known as “franchise agreement” but license agreement in Jordan; while parties are known as licensor and licensee (Trademark Act [TA], 1952).

Similar to other contracts, franchise contract also contains agreement pertaining to the involved parties’ rights and obligations. Apart from that, franchise contract contains certain special characteristics. Due to this, franchise contract is majorly defined by national law and international organization law (Ty, Olson, & Tinh, n. d.). Nonetheless, franchise contract still differs from other contracts, for instance, the agency contract and the distribution contract, in a number of ways (Ty, Olson & Tinh, n. d.). For example, the franchised products are distributed by the franchisees under the franchisor’s trademark while distributors sell the products under their own name although they may have displayed the trademarks of the product.

In the context of France, the concept of franchise contract has been pointed out in the case 161/84, Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis [1986] ECR 353, a well-known case. In this case, the Court of Appeal of Paris stated the validity of franchise contract as a means for deriving financial gains from its expertise without investing its own capital, not as a way of distribution. With respect to this case, the concept of franchise agreement was also described by the European Court of Justice as a commercial cooperation between independent undertakings that are contractually governed, in which, one party known as the franchisor, grants one or more parties, known as the franchisee(s), the permission to utilise his trademark or trade name as well as any other distinctive characteristics of the franchisor in selling products or services. The sale occurs based on a special marketing system or formula that the franchisor had developed. In return, the franchisee pays royalties to the franchisor. The franchisee’s utilisation of these rights is under the franchisor’s supervision in order to guarantee consistency in terms of the presentation to the public and the quality of the goods or services.

In its memorandum and articles, the British Franchise Association presents another definition of franchise contract as a contractual license granted by one person (the franchisor) to another (the franchisee) which permits or requires the franchisee to carry on during the period of the franchise a particular business under or using a specified name belonging to or associated with the franchisor (British Franchise Association [BFA], 2015). It entitles the franchisor to exercise continuing control during the period of franchise over the manner in which the franchisee carries on the business which is the subject of the franchise and obliges the franchisor to provide the franchisee with assistance in carrying on the business which is the subject of the franchise, in relation to the organization of franchisee’s business, the training of staff, merchandising, management or otherwise (BFA, 2015).

Based on the definitions of franchise contract above, it can be deduced that a franchise contract entails a parties’ set of terms which must contain at least three important components. The first component deals with elements of transfer of the right of industrial or intellectual property from the franchisor to the franchisee with the intention
of profit attainment. The second component is about the franchisor’s assistance to the franchisee in process carry on franchise while the last component is the financial obligation of the franchisee to the franchisor. Having these elements, the franchise contract’s legal nature of franchising is precisely expressed and this assists in the differentiation between franchise contract and other contracts which share certain characteristics.

2.2 The Franchise Concept

According to the Australian House of Representatives Standing Committee on Industry, Science and Technology, franchising is a widespread type of economic organization that provides an alternative means to expanding business or it is an alternative way of entering the industry (Parliament of Australia, 2015). It is basically a business operation that revolutionized the distribution of goods and services in almost all industrial sectors and has reformulated the business landscape of many countries (Terry & Binh, 2009).

The term ‘franchise’ means the granting of freedom to do something or the right to use something in a certain location. The origin of the term can be traced back to the French verb “affranchir”, which literally means “to free” (Izraeli, 1972). In Europe, during the Middle Ages, local authorities used to grant franchises within their domain. Franchisees had an exclusive right to carry out business within that domain and to stop other people from interfering in their business. By the 18th-19th century, the term franchise was used extensively in Britain to provide a description of specific business privileges provided by the royal and legislative bodies (Izraeli, 1972).

In the present day, ‘franchise’ refers to a commercial relationship for the distribution of products and services. According to the Swanson Committee of Australia, franchising can be categorized into three, namely product franchising, processing or manufacturing franchising, and system franchising (business format franchising) (Swanson Committee, 1976).

Product franchising and processing/manufacturing franchising are both referred to as product and trade name franchising (Vaughn, 1979). In the context of product franchising, the franchisee is more of a distributor (wholesaler or retailer) of a certain product. This type of franchise is commonly utilized in retailing new motor vehicles. On the other hand, in processing/manufacturing franchising, the franchisor provides the secret ingredient and know-how to the franchisee, for example, in the soft drink industry. Product and trade name franchising is the pioneering generation of modern franchising and it first surfaced in the mid-nineteenth century (Blair & Lafontaine, 2005). The pioneering product and trade name franchise is deemed to be the Singer Sewing Machine Company. Owing to the lack of capital needed to hire significant number of sales staff or to establish distributing branches for sewing machines, as well as to train potential customers and service the machines, the company provided the right to use its trademark to agents within exclusive territory in order to sell and provide sewing machines services (Godley, 2006).

While product and trade name franchising is a relatively unsophisticated form of franchising consisting of branded distribution arrangements and system franchise (business format franchising), the major contemporary form of franchising is a sophisticated business relationship (Justis & Judd, 1989). In the business format franchise, the franchisor equips the franchisee with the trademarked product along with the entire business model and operational and managerial systems reinforced by standards, training and continuous assistance (Terry, 1991).

Specifically, the business format franchise is a contractual arrangement between two legally independent firms where one firm (the franchisee) pays the other (the franchisor) for the right to sell the product and use trademarks by duplicating the business format of the former in a certain location for certain duration. The first business format franchising system is the Harper Beauty Shops owned by Martha Mathilda Harper back in the 1890's which was established in the United States (Plitt, 2000). Nevertheless, this type of franchising only began developing in the 1950s with the help of companies like McDonald’s and Kentucky Fried Chicken (KFC). The recent exponential growth of franchising is attributed to this type of franchising (Terry, 1991). In 2005, an extensive report of the International Franchise Association concerning the economic impact of franchised business revealed that business format franchising in the U.S. outperformed product distribution franchising, constituting around 5.7 times as many businesses and 4.5 times as many jobs (IFA, 2008).

The classic and most basic format franchise model is the single-unit franchise, which is an agreement whereby the franchisor provides the franchisee the rights to operate a single franchise unit (Beshel, 2001). Currently, this classic form of franchising is widely known as the ‘mom and pop’ franchising. In this franchise type, the franchisees spend all their time and energy operating a single outlet (Welsh & Alon, 2002). With the increasing sophistication of franchisors, their systems and their franchisees, multi-unit franchising where a franchisee operates more than one unit has become more common (Welsh & Alon, 2003).
Particular structured forms of multi-unit franchising are area development franchising and master franchising. (Binh, 2012). In an area development franchise, the franchisor grants a franchisee (so-called ‘developer’) the rights to open and operate more than one unit in an agreed time frame and within a specified area (Mendelsohn, 1995). In a master franchise agreement, the franchisor grants a franchisee the rights to exploit a territory where the franchisee can open and operate a number of company owned units and also can grant franchises to others through sub-franchise agreements (Mendelsohn, 1995).

It is without doubt that franchising can metamorphose into various types to adapt to different situations and changing market environments. Moreover, franchising adaptive and innovation capacity is the engine behind its dynamic development (Terry & Lernia, 2013). However, owing to the variety of franchising elements and their overlap with other types of legal business transactions, confusion reigns as to the nature of the transaction, which is subject of the franchise agreement (Mendelsohn & Freedman, 2004). Therefore, franchise law should be regulated to define the franchise agreement and identify the legal aspects of such contract.

2.3 Regulating Franchising

In order to support an orderly development of franchising, it requires a healthy and underlying commercial law environment (Terry, 2002). However, increasingly it is a matter of vigorous controversy regarding as to whether a dedicated franchise law is necessary or not to supplement general application of commercial laws (Terry, 2003). Nevertheless, if there is a franchise specific law, here are the concerns that this could threaten its development as it curtails the entrepreneurial nature of franchising (Mendelsohn, 1999). On the other hand, with the introduction of a franchise specific law, it is believed that it can help to ensure the sustainable growth of franchising. There are several reasons why franchise specific laws are introduced. Among them are that it can be due to a desire to resolve the problems that have arisen, to redress the balance between the parties to an agreement where the necessary balance either does not exist or has been distorted, and to ensure that abuses either do not occur or, where they have occurred, would not occur again (Peters, 2000).

A case in point is that of Australia where in 1998, it introduced a mandatory Franchising Code of Conduct prescribed under the Trade Practices Act 1974. This was done in response to the report of the Australian House of Representatives Standing Committee on Industry, Science and Technology (Parliament of Australia, 1997). In that report, the said committee came to a conclusion that the earlier system of self-regulation was not workable. As such, it was necessary that codes of conduct with legislation be instituted instead.

Under the Franchising Code of Conduct, a franchisor prior disclosure is required and it regulates the franchisor-franchisee relationship. Most importantly, a wide support from the franchise sector has been given. In a later submission to the government, the Franchise Council of Australia commented that the Code has had a beneficial effect on the franchising sector. There exist overwhelming support for a Code and the franchise sector does not seek to revise the Code from a policy perspective (Terry, 2003).

Between the years 1999 and 2002, surveys of franchising were conducted by the University of Southern Queensland. They found that after the introduction of the Franchising Code of Conduct, the franchising development was slowing down (Terry, 2003). However, they regarded it as a positive sign as it indicates that the franchising sector is consolidating and that the reduction in net growth reflects the sector’s increasing maturity in the country (Terry, 2003).

The international trend towards adopting dedicated franchise laws evolved as there are increasing acknowledgments regarding the matter. This comes from the Council of Small Business Organizations in Australia, especially in circumstances of franchising where there are different elements to normal business development (Binh, 2012). It can be seen that in order to address the information and power imbalances that are inherent in the franchise relationships, franchise specific laws are adopted. Therefore, franchise law in Jordan should be adopted in line with the international trend and address the problems arisen in franchise business. Thus, this will ensure the fairness between the parties in the franchise agreement.

3. Main Laws Governing Franchise in Jordan

There is no specific act governing the legal aspect of franchise agreement in Jordan. However, certain general provisions of several acts may affect franchise agreement in Jordan such as the Trademark Act (1999) and Unfair Competition and Trade Secret Act (2000). These two legislations contain general provisions that can affect the elements of franchise in a franchise agreement.

3.1 Trademark Act (1952)

In Jordan, the Trademark Act gives the owner of a trademark the right to use his trademark similar to any other property. This right includes the legal rights to sell, mortgage and give licence to the other person to use the same
trademark. In relation to the Trademark Act, a franchise agreement can be identified as a license agreement provided in the Act.

The franchise contract is a contract whereby the franchisor gives the right to others to use his trademark for a certain period with payment of fees (Salah, 2009). Thus, the franchisor will have the right to get payment from the franchisee while the franchisee will have the right to use the trademark. In addition, both parties have a duty to draw up a written contract and set the terms and conditions that they can agree upon.

According to section 26 (2) of the Trademark Act, the owner of trademark can give license to one person or more to use his trademark by a written contract registered in the Trademark Registration Office at the Ministry of Industry and Trade. This licence can be for the whole products that the licensor sells or part of it, and such contract cannot exceed the trademark registration period (Trademark Act [TA], 1952).

The period for trademark registration is stipulated as ten years from the registration date, and this period is renewable after every ten years according to the Trademark Act in section 20 (1). According to this section, the trademark ownership right shall be for ten years as of the trademark registration date and may be renewed for another ten years periods under the provisions of the Act (TA, 1952). However, no clear idea has been provided concerning the franchise agreement period – as this provision is not applicable for the franchise contract period. For instance, after eight years of registering the trademark, the franchisor grants the franchisee the license to use the trademark, and in such a case, the contract term will only be for two years and hence, the franchisor as well as the franchisee will fall short of obtaining the agreement’s potential benefits.

The franchise agreement length is dependent on the intentions of the franchisor, the premises potential life, and other factors that differ from one contract to the next. It is however common for franchise agreements to have a long duration in order to enable the parties to obtain the potential profits from the agreement. Such a long term agreement also enables the franchisor to obtain the expected profits from the business and the franchisee to satisfactorily develop the franchise business in the eyes of the franchisor. Hence, if the duration of the franchise contract is linked with the trademark registration term, the parties’ interests may be affected and this may prevent them from achieving their contract objectives.

On the other hand, the Trademark Act prevents any third party from using a trademark without license as this is considered as criminal action. The violation of this provision makes a person liable to criminal sanction. According to section 38 (1) (b) of the Trademark Act, each person who assisted or incited the use of trademark owned by another person illegally without license is liable to an imprisonment for period not exceeding one year or fine not exceeding three thousand Jordanian dinars or may be liable for both (TA, 1952). Thus, the Trademark Act provides the protection for the franchisor by preventing others from using his trademark without license under the franchise contract. Nevertheless, the Trademark Act does not protect neither the franchisor nor the franchisee in the event of breach of the terms and conditions of franchise contract by any of them.

3.2 Unfair Competition and Trade Secret Act (2000)

A potential purchaser of a business, for example potential franchisee, will want to know the business’s turnover and profit. With the purchase of existing businesses, the information such as turnover and profit can be provided. Some vendors, however, are less than truthful and many purchasers claim that misrepresentations have been made over turnover and profit levels (Gunasekara & Sims, 2007). The Unfair Competition and Trade Secret Act focuses on the issues regarding the confidentiality of commercial contracts including franchise contract, the scope of confidentiality includes all secret information regarding the business, such as turnover and profit. There is no doubt that secrets are important element of a franchise.

Accordingly, section 4 (A) of the Unfair Competition and Trade Secret Act considers any information as trade secret if this information usually unknown in its final form or components or not easy to be obtained by the people who are dealing with, has commercial value and the person who owned this information made some measures to keep it secret. Therefore, it can be said that confidential information covers the franchisors marketing manual, promotions management manual, concept overview manual and other manuals dealing with specific topics such as operations, human resources, finances and administrations and purchasing of the franchise business (Unfair Competition and Trade Secret Act [UCTSA], 2000).

In addition, a franchisor has the right to protect his confidential information absolutely from anyone, as section 5 of the Act mandates that the franchisee must keep the confidential information of the franchisor intact and require each of his employees not to disclose such confidential information (UCTSA, 2000).

It should be noted that both the franchisor and the franchisee have the right to prevent each other from disclosing the confidential information of the franchise business to any third party. This is due to the Act which considers
each person (franchisor or franchisee) has the right to give, keep or use secret commercial information as owner for this information and has the right to prevent others from misusing this information under the provisions of this Act, and the Act does not determine specific type of people to apply these provisions on them (UCTSA, 2000).

In addition, the Act prohibits a breach of confidentiality duty in several forms. According to section 6 of the Act, the misuse of trade secret information can be considered as a breach of the honest commercial practices provided under the Act. This will include breach of the franchise contract, breach of the confidential information relating to the franchise entrusted by the franchisor and obtaining trade secrets from a third party if the person knows or can know that this third party got the information by breaching honest commercial practice (UCTSA, 2000).

The provisions provided by the Act do not mention franchise in particular. However, it can be argued that the law can affect the confidentiality provision and also relevant trade secrets in a franchise agreement. The Act also does not state or provide any criminal penalties for breach of its provisions. However, the Act in section 7 gives the right to the trade secret owner to claim for compensation regarding any damages resulting from misuse of his trade secrets. For example, he can claim to discontinue the abuse and seize the materials that contain trade secret misused or the products resulting from misuse of the trade secrets (UCTSA, 2000).

Furthermore, the franchisor controls the franchise system, brand name, marketing strategy and intellectual property, all of which are among the main elements of the franchise business and important for the franchisee (Frazer et al., 2012). For example, the franchisor might set condition in the contract to grant back to himself any innovation activities made by the franchisee. However, the law has more power to control terms and conditions that are created by the parties in the contract.

The Act provides an advantage to the franchisee where the Act, in section 9 (A) clarifies that each term or condition contained in the franchise agreement that might affect negatively on the trade is considered void. This section listed the conditions that might affect negatively on the trade such as preventing the franchisee of grant the improvements that he added to the business to other than the franchisor or preventing the franchisee to claim compensation regarding the trademark or brand name affected by unfair competition action (UCTSA, 2000).

4. Conclusion

The above discussion purports to explain relevant Jordanian laws i.e the Trademark Act and the Unfair Competition and Trade Secret Act in relation to franchise business in Jordan. Among the basic of franchise contract identified in the above said laws includes granting license to franchisee to use the franchisor trademark as well as getting protection against a third party of using the trademark without license, confidential information related to the franchise and innovation activities that can be made by both the franchisor and the franchisee, these provisions can be applied on every contracts including franchise contract. However, the franchise business is not the same as starting a new business or even purchasing an existing standalone business. If a person sets up his own business or buys an existing business, he dictates how and where the business is to be run, how long it will run for, and any goodwill generated by that business is retained by that business, whereas in the case of a franchise business it is the franchisor who dictates all those things. This is because franchising is a hybrid between an independently owned business and a vertically integrated company owned operation. Due to its unique business nature, current laws are insufficient to govern franchise agreement in Jordan. There must be a specific legal framework that can cater for franchise agreement, as the franchise is one of the lucrative investment markets in Jordan.

To conclude, the lack of specific legislation would certainly deter or at least slow down the progress of the foreign and local investor setting up franchise businesses in Jordan, as they could not reasonably anticipate what await them in the market. These in turn, will hamper the development of the country and the working opportunity of the people. Thus, in order to encourage successful homegrown franchises in Jordan, it makes sense for all franchises both local and international to be governed by the same set of rules. The law must ensure that fair rules govern business format franchises and better protection for the interests of both the franchisors as well as the franchisees. All in all, the costs associated with regulations will be outweighed by the benefits.

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