

A PRIMER ON FRANCHISING IN COLOMBIA

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I. Preliminary Comments

With the exception of a few publications, no sources reliably provide evidence of the overall local performance of foreign or domestic franchising in Colombia. The absence of information not only relates to data associated to the number and extent of successes and failures in the franchising business within the last few years, but also to the way specific laws and regulations currently in force could become applicable to franchising agreements.

Legal concerns on franchising are mostly based on the following grounds: (1) Inexistence of specific laws and regulations in the Andean Community legislation and the local realm. (2) Lack of relevant judicial developments related to this sort of contract. (3) Absence of voluntary or imposed information requirements demanded from prospective franchisors (e.g., special registration or disclosure requirements for franchisors –for example FDD- prior to setting a franchise network in Colombia).

These concerns do not imply, however, that franchising has not developed in Colombia within the last years. In fact, most famous foreign franchise networks seem to be performing well in this country (Mc. Donald's, Domino's Pizza, Subway, among many others, are clear signs of how successful foreign franchising has been in Colombia). Notwithstanding, as it was said above, no reliable data on the overall performance for these networks is publicly available.

Because of the lack of precise information, the comments made in this brief are mostly based on the professional experience of the author in the negotiation of local and foreign franchise agreements and follow up of the news on a regular basis.

II. Franchising Contract in Colombia: Where is the Law?

As it was said, the most relevant legal feature of franchising contract in Colombia is that it is not explicitly regulated by any Andean or local law, nor has it been analyzed thoroughly by judicial courts or arbitral tribunals. This does not mean that negotiating, performing a franchise agreement in Colombia is not legally possible,

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or simply, that once a foreign entity has negotiated a contract such an agreement is not enforceable.

According to article 1602 of Colombian Civil Code (applicable not only to civil but also to commercial agreements, and to franchising among the latter), the contract between the parties is the law between them and should be fully performed. This, unless contractual stipulations are against public policy. Article 1602 has been interpreted as the recognition of the principle of sanctity of contracts in Colombian law. According to this, once franchisor and franchisee have agreed on the basic features of a franchise agreement, such an agreement becomes legally enforceable for both parties, unless, as it was mentioned, the contract stipulations are against public policy (ordre public).

Consequently, franchisor and franchisee are in general free to perform a franchising relationship whose stipulations are enforceable in good faith.

III. Negotiating and Drafting a Franchise Contract: some Specific Issues Foreign Franchisor should bear in mind

Despite the existence of the principle of liberty of contract in Colombia, some caveats should be considered by foreign franchisors when negotiating these sorts of contracts in Colombia:

1. Franchisor should register her trademarks, logos and slogans (pursuant to Andean Decision 486 of 2000) and keep all registrations in force at all times. Franchisee should monitor Franchisor's trademarks registrations and review the market on a regular basis, in order to detect trademark infringers of Franchisor's trademarks. In such cases, Franchisee should advise Franchisor of any potential threats against her IPRs.
2. Franchise contracts should be in writing: the overall legal framework for franchising in Colombia does not require a franchise to be in writing. In fact, unless patents or industrial designs are licensed by franchisor to franchisee, US-Colombia Free Trade Agreement implementing legislation on Industrial Property (Decree 729/2012, article 5) abrogated registration requirements for trademark licensing agreements at the Trademark Office (Superintendence of Industry and Trade in our case) as a prerequisite for contract validity or enforceability. However, no serious franchisor should ever consider franchising her business through a sole verbal agreement with no compiled or memorialized written form.

3. Franchise contracts should be regulated in-depth: based on the fact that there are no specific laws applicable to franchise contracts in Colombia, and that article 1602 of Colombian Civil Code allows parties to specify most contractual features, Franchisor should try to make her best to regulate to the maximum detail possible all foreseeable situations. This not only allows Franchisor to assure the stability of her business format and the protection of her trade secrets, but also reduces the risks of analogical interpretation or application of similar legislation by a judicial court or arbitrator. This is especially significant regarding the agency contract, which establishes substantial compensations for the agent upon contract termination. Commercial Agency law also prohibits choosing foreign laws to govern the relationship when the agent performs her tasks in Colombia (article 1328 Colombian Code of Commerce).

4. It is not recommendable to copy the original franchise agreement drafted in Franchisor's home country. For example, references to topics not applicable in Colombia (e.g., citation of Foreign regulations or procedures) brings about the idea of ethnocentrism and could rise the sense that foreign franchisor is not advised of the local legal system particularities.

5. Agency Contract provisions should be expressly ruled out: in all franchise contracts to be performed in Colombia, Franchisor should take all measures possible to avoid any reference to the agency contract or its provisions. This should be especially worked out in case the franchise scheme involves the distribution of franchisor's products by franchisee. As previously stated, the Colombian Code of Commerce (CCC) states that in case an Agency Contract is Terminated, principal should pay the agent a 1/12 compensation of annual commissions or royalties earned by agent for every year the contract was in force (article 1324). Therefore, explicit exclusion of agent regulations is highly advisable for franchising contracts to be performed in Colombia.

6. Arbitration: Colombian judges are not very familiar with franchising contracts. Consequently, it is advisable to submit resolution of possible disputes to arbitrators. Chambers of commerce in Colombia's major cities have reliable, efficient and comfortable arbitration centers and arbitrators to solve these sorts of issues. Based on Law 1563 of 2012, foreign law to govern the contract could be agreed upon, when the contractual relationship has relevant foreign contacts (e.g., the places of business of the parties differ or a substantial part the agreement is performed overseas).

IV. Other Laws and Regulations Franchisor must bear in mind to achieve a successful contractual relationship

1. Compliance with mandatory national and local regulations: as it is customary in other countries, some areas of business are strictly regulated in Colombia. For example, food, and pharmaceutical sectors (including natural or homeopathic ones), and stores or offices related to these sorts of products should comply with national and local sanitary rules and regulations.

2. Antitrust and Foreign Investment Law Controls: It is important for franchisor to bear in mind resale price clauses (price fixing) to franchisee, bid rigging, and tying agreement provisions (among others) are considered antitrust law infringements. Therefore, they should be avoided in domestic and foreign franchise agreements, especially when one of the parties holds a dominant within the relevant market. This is especially significant, as Law 1340 of 2009 raised antitrust fines substantially (up to USD 23 million in case of corporations).

3. Quality Controls and Franchisor Liability in case of Defective Products: according to Article 554 of CCC, Licensor (and consequently Franchisor) should implement quality controls regarding the goods or services provided by Licensee (Franchisee). In case Franchisee sold or provided defective products or services, Franchisor would be held liable for Consumer Protection Infringement (pursuant to Law 1480 of 2011) and would be obliged to pay adequate compensation to consumers as well as applicable fines ordered by Superintendence of Industry and Trade (Superintendencia de Industria y Comercio - SIC).

4. Taxation issues: Payment of royalties and other fees to foreign persons (either natural or juridical), who live outside Colombia is heavily taxed in this country. All remittances must pay a 33% withholding tax. It is strongly advisable for Franchisor to allow franchisee to pay withdrawal taxes in full and deduct them from the total sums of royalties to be remitted, proportionately.

V. Conclusion

Although franchising is not explicitly regulated by Colombian laws, many domestic laws and regulations are applicable to these sorts of agreements. Franchisor should make her best to establish extensive clauses to face this “local franchising law deficit” and pay special attention to the laws and regulations regarding Intellectual Property Rights and Trade Secrets, Consumer Protection, Antitrust, and Taxation. In order to reduce the risk of analogical application by a judge or

arbitrator of agency compensation provisions, Franchisor should carefully rule draft in-depth and detailed clauses and rule out the applicability of the agency contract compensation rules in case of contract termination.

Franchisor and Franchisee should stipulate an arbitral clause, to reduce the risks of inappropriate decisions made by local judges. Colombian Chambers of Commerce have competent arbitration and conciliation centers whose arbitrators are familiar with the features and challenges of franchising for Colombian legal system.
