



# Franchise

in 30 jurisdictions worldwide

# 2014

Contributing editor: Philip F Zeidman



**Published by**  
***Getting the Deal Through***  
**in association with:**

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### Franchise 2014

Published by  
Law Business Research Ltd  
87 Lancaster Road  
London, W11 1QQ, UK  
Tel: +44 20 7908 1188  
Fax: +44 20 7229 6910  
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First published 2006  
8th edition

ISSN 1752-3338

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Printed and distributed by  
Encompass Print Solutions  
Tel: 0844 2480 112

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# Indonesia

Galinar R Kartakusuma and Reagan Roy Teguh

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## Overview

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

The typical franchisor would usually take the form of a limited liability company whose capital is divided into shares.

### 2 What laws and agencies govern the formation of business entities?

The formation of limited liability companies in Indonesia is governed by the Companies Law (Law No. 40 of 2007) and administered by the Ministry of Law and Human Rights (MOLHR).

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

In general, a limited liability company must be formed by at least two parties by executing a deed of incorporation and articles of association before a notary public. The notary then files the deed of incorporation and articles of association with the MOLHR for its approval. Upon obtaining MOLHR approval, the company attains legal status and the shareholders' liability will be determined by the amount of issued shares to which they subscribed. The MOLHR will then arrange for the publication of the deed of incorporation and articles of association in the Supplement to the State Gazette of Indonesia.

Thereafter, the company must be registered in the Companies Registry that is maintained by the local office of the Ministry of Trade (MOT). The MOT will issue a company registration certificate valid for five years (renewable). Another division of the MOT will issue an operating business licence that is valid for as long as the company is in operation. Any changes to the company's shareholders, board of directors, commissioners (supervisory board), domicile, etc, must be reported to the MOLHR and the MOT. The company must convene annual general meetings of shareholders to discuss and approve, among other things, the annual report and financial statements prepared by the board of directors. Extraordinary general meetings of shareholders may also be held when required.

### 4 What restrictions apply to foreign business entities and foreign investment?

Foreign business entities may conduct business in Indonesia through direct investment, the capital markets, a joint operation or other forms of joint venture, through a representative office, or by appointing an Indonesian agent or distributor. Activities in certain business sectors cannot be undertaken by foreign entities. Foreign business entities may establish a foreign investment company in Indonesia to undertake business activities that are open to foreign investment. Foreign investment companies fall under the auspices of the Indonesian Capital Investment Coordinating Board. To undertake certain business activities (such as mining), foreign investors

require a recommendation or approval from the relevant technical agency or agencies.

Foreign entities may not carry out retail businesses, except if conducted on a large scale. Foreign investment in the financial sector is regulated by the Ministry of Finance. There is no foreign exchange control. However, any movement of foreign currency worth US\$10,000 or more must be reported to the Indonesian Central Bank by the facilitating bank in Indonesia. In addition, the bank must obtain the following documents from its customer or the foreign party if they wish to purchase foreign currency against Indonesian rupiah and the total amount will exceed US\$100,000 (or its equivalent in other currencies) per month per customer, including purchases of foreign currencies for derivative transactions:

- a copy of the underlying document;
- a copy of the relevant Tax Registration Number (only applicable to Indonesian parties); and
- a statement from the bank's customer or the foreign party that the underlying document is a valid document and that the foreign currency will only be used to settle payment obligations connected with the underlying documents.

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

Foreign businesses and individual residents of Indonesia will be subject to income tax. Some tax matters that should be considered include value added tax (VAT), withholding tax and permanent establishment.

VAT is levied on supplies of goods and services within the customs area of Indonesia and those imported into the customs area. VAT also applies to services performed abroad but enjoyed in Indonesia. Therefore, VAT is payable on the provision of services by the franchisor to the franchisee, regardless of the place of performance.

The general rate of VAT is 10 per cent. VAT on luxury goods is 10 to 200 per cent.

#### Withholding tax

Tax on the importation of goods and the use of foreign services is paid by the importer or user. Under Indonesian tax law, a foreign franchisor, as a non-resident taxpayer, does not have the obligation to withhold taxes.

#### Permanent establishment

Foreign companies with no permanent establishment in Indonesia are subject only to a final withholding tax on certain types of income derived from Indonesian sources. A permanent establishment of a foreign corporation is liable for regular Indonesian corporate tax on profits directly or indirectly attributable to its permanent establishment in Indonesia. In addition, a 20 per cent 'branch profit' tax (reduced by tax treaty; 10 per cent in the case of the United States)

is imposed. With respect to services and contracts to be performed in Indonesia, a foreign corporation from a tax treaty country (such as the United States) is considered to have a permanent establishment should its employees be present in Indonesia for business purposes for more than 60 days in a 12-month period (in some cases a 90-day or 120-day limit applies, depending on the tax treaty of the relevant country). If the franchisor plans to send any staff to Indonesia, it should seek tax advice in relation to this issue. If no staff are to be sent to Indonesia, the franchisor and its affiliates should ensure that their franchise arrangement is not viewed as permanent establishment.

- 6** Are there any relevant labour and employment considerations for typical franchisors? What is the risk that a franchisee or employees of a franchisee could be deemed employees of the franchisor? What can be done to reduce this risk?

In general, labour law would not apply to franchisors, unless franchisors employ Indonesian nationals or expatriates to work in Indonesia. To minimise the risk of a franchisee's employee being deemed an employee of the franchisor, the franchisor must ensure that the relationship with the franchisee is that of an independent contractor and expressly provide for this in the franchise agreement. If the franchisee requires assistance from the franchisor's employees on a more permanent basis, the employees should be employed by the franchisee.

- 7** How are trademarks and know-how protected?

Foreign and domestic franchisors may protect their trademarks and know-how in accordance with the prevailing intellectual property rights laws. Trademarks are registered with the Indonesian Trademark Office of the Directorate General of Intellectual Property Rights, and know-how may be protected under patent or relevant IPR laws (industrial design, copyrights, trade secrets). There is no obligation to register a copyright, but it is recommended.

Trade secrets are also protected under the Indonesian Trade Secret Law (Law No. 30 of 2000) and the Anti-Monopoly and Unfair Competition Law. Under the Trade Secret Law, an agreement containing the granting of rights to use trade secrets must be registered with the Directorate General of Intellectual Property Rights (Directorate). The agreement will further be published in the Official News of Trade Secrets. One consequence of not registering the agreement is that it will not bind third parties. According to the Trade Secret Law, the procedures for registration will be regulated by the government; although said government regulation does not yet exist. Given this fact, the Directorate is not able to formally process any registration of such an agreement. As registration of agreements is nonetheless important, it is advisable to submit the agreement even though the Directorate cannot process it and the submission would not be considered a valid registration. The fee for registering this agreement is 150,000 rupiah per application for a small scale business or 250,000 rupiah per application for a large scale business.

Please also see question 38 regarding the use of the Indonesian language in agreements that involve an Indonesian party.

- 8** What are the relevant aspects of the real estate market and real estate law?

The franchisee will have to purchase or lease the real estate for its shop from the property owner. Under the Indonesian Civil Code (ICC), the lessee will have the right to enjoy the leased property until expiry of the lease term. If the property is transferred to a third party, the new owner cannot terminate the lease without the consent of the lessee. Care should be taken that the property is located in an area designated for commercial purposes (as opposed to residential

purposes). In general, non-resident foreign franchisors will not be able to purchase real estate. Resident foreigners may purchase property under a specific right – namely the right to use title – and under certain conditions: namely, that their presence must be 'of benefit to national development' and their ownership is limited to one property.

#### **Laws and agencies that regulate the offer and sale of franchises**

- 9** What is the legal definition of a franchise?

A franchise is described as a special right that is owned by an individual or an entity over the unique characteristics of a business system that has been successful in the promotion of goods or services, and can be used by another party pursuant to a franchise agreement.

- 10** Which laws and government agencies regulate the offer and sale of franchises?

Government Regulation No. 42 of 2007 dated 23 July 2007 on Franchising (Regulation No. 42) and its implementing regulation, Regulation of the Minister of Trade No. 53/M-DAG/PER/8/2012 dated 24 August 2012 on Implementation of Franchising (Regulation No. 53), and Decree of the Director General of Domestic Trade No. 138/PDN/KEP/10/2008 dated 31 October 2008 on the Technical Guidelines for the Implementation of Franchising (Decree No. 138). Also, specific regulations have recently been issued by the Minister of Trade on, respectively, Modern Store Franchising (Regulation Number 68/M-DAG/PER/10/2012 – Regulation 68) and The Development of Partnerships in Franchising for Food and Beverages Services Business Activities (Regulation Number 07/M-DAG/PER/2/2013 – Regulation 07).

- 11** Describe the relevant requirements of these laws and agencies.

A franchise must fulfil the following criteria:

- have a specific business characteristic;
- be a proven successful business, which refers to the franchisor having business experience of approximately five years;
- have a written standard operating procedure to enable the franchisee to conduct its business in accordance with the franchisor's business system;
- be easy to learn and apply;
- provide continuous support to the franchisee; and
- have a registered intellectual property right.

Prior to entering into a franchise agreement, a franchisor must provide a prospectus disclosing its business data or information to a franchisee at least two weeks before the execution of the franchise agreement.

There are also certain restrictions applied to franchises in general, and specific restrictions addressed to modern store businesses and food and beverages businesses. See questions 13 and 14.

- 12** What are the exemptions and exclusions from any franchise laws and regulations?

In general, there are no exemptions. However, we were informed that in certain cases, at the recommendation of the franchise assessment team, the relevant ministry may issue a permit to use less than 80 per cent of domestically produced products and services. In addition, there are no clear guidelines as to how this recommendation will be issued. See questions 13 and 14.

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

The Franchise Law stipulates that the franchisor must have been in business for five years. Its franchise business must still be in operation and must be profitable.

A franchisee that has been granted the right to sub-franchise must have at least one company-owned operation.

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

Under Regulation 53 a franchisor may not appoint a franchisee with which it has a direct or indirect control relationship. Such measures mean that this would be a relationship with common shareholders rather than a management relationship. Hence, a franchisor cannot appoint a subsidiary or affiliate as its franchisee. Further, both franchisor and franchisee can only operate in business activities specified in their business licences, ie the franchise business should be the line of business specified in their corporate documents (articles of association or bylaws) and the technical licences issued by the relevant technical ministry. Regulation 53 also requires franchisors to cooperate with local small and medium businesses (SMEs) as franchisees or suppliers, if they can satisfy the franchisor's requirements. Franchisors and franchisees must use domestically produced goods or services for at least 80 per cent, consisting of raw materials, business equipment and merchandise which will be measured by number of items (not by value). The minister of trade may exempt a franchise from this requirement in certain cases, based on the recommendation of an assessment team. In certain cases, the franchise business may also sell up to 10 per cent supplementary goods out of their total offered items. However, there are no further guidelines on how the cooperation with SMEs is to be implemented, or how the recommendation will be issued or what may be considered 'certain cases'. The satisfaction of those requirements by the parties to a franchise arrangement should be provided in the annual report submitted by the franchisor and franchisee to the Ministry of Trade.

In the event of unilateral termination by the franchisor, a clean break letter or alternatively a final and binding court ruling is now required before the franchisor can appoint a new franchisee for the same territory.

The total number of outlets to be managed by the franchisee must be stated in the franchise agreement. However, specific franchise regulations (ie, Regulation 68 and Regulation 07, now impose limitations on the number of outlets managed or owned by a franchisor and a franchisee). Regulation 68 stipulates that franchisors and franchisees engaged in a modern store business may operate up to 150 company-owned outlets. Thereafter, they must appoint independent sub-franchisees. This requirement applies to mini markets with an area of 400 square metres or less, supermarkets of 1200 square metres or less and department stores of 2000 square metres or less. Exemption to this requirement may be applied in certain circumstances. Regulation 07 limits the number of self-managed or owned outlets for franchisors and franchisees in the food and beverage businesses (restaurants, bars, and cafés) up to 250 outlets. Any additional outlets must either be franchised or operated by way of cooperation with capital participation.

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

The law does not explicitly regulate this. A master franchisee will act as a franchisor in a sub-franchising arrangement, therefore the

provisions applicable to a franchisor will also apply to a master franchisee. The sub-franchisor must provide disclosure of its proposed sub-franchising. The scope of disclosure will be similar to that which must be disclosed by the franchisor. See questions 16 and 17.

In addition, in a sub-franchising arrangement, the master franchisee is required to own and manage by itself at least one of the businesses that it is permitted to sub-franchise.

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

The franchisor must provide the disclosure document at least two weeks before execution of the franchise agreement. Although the law does not impose an obligation to update the disclosure, it is advisable to do so. The disclosure document must be registered with the MOT for franchises originating from Indonesia and outside Indonesia, following which the franchisor or sub-franchisor will receive a franchise registration certificate (the franchisor certificate). An application form must be submitted with a copy of the prospectus and details of the franchisor's business legality.

Regulation No. 53 requires that for the prospectus to be registered with the MOT it must be legalised by a notary public, with an attached statement or reference letter issued by the relevant trade attaché or Indonesian consulate in the home country of the franchisor. Also, a prospectus in a foreign language must now be sworn translated into the Indonesian language. The information provided in the application for a franchisor certificate includes, among other things, the franchisor's name, country of origin, franchised products or services, types of intellectual property rights owned and the name of the person responsible for the franchisor and his or her contact details. The franchisor certificate is valid for five years and may be renewed every five years for the same term.

- 17** What information must the disclosure document contain?

As a minimum, the following information must be included in the disclosure document:

- the identity of the franchisor, covering information provided in the identity cards or passports of shareholders, commissioners and board of directors (if the franchisor is a business entity);
- the business legality of the franchisor, covering information on the franchisor's business licence;
- the business history of the franchisor, covering information regarding the establishment of the franchisor, business activities and the development of the franchisor's business;
- the organisational structure of the franchisor, covering the management hierarchy, from commissioners, shareholders and board of directors to the organisational structure of the operating division;
- the audited balance sheet for the past two years;
- the number of franchise businesses, covering the number of outlets owned by the franchisor;
- the list of franchisees; and
- the rights and obligations of:
  - the franchisor, such as the right to receive royalties and the obligation to provide continuous assistance to the franchisee; and
  - the franchisee, such as the right to use the franchisor's intellectual property rights or business characteristics and the obligation to keep confidential the intellectual property rights and business characteristics.

- 18** Is there any obligation for continuing disclosure?

As advised above, the law does not require the disclosure document to be updated. However, we understand that in practice, it is

advisable to continuously send updates for the disclosure document to each prospective franchisee and the MOT.

**19** How do the relevant government agencies enforce the disclosure requirements?

There are no regulations regarding enforcement of the disclosure requirements, except the enforcement of the disclosure registration itself. An administrative sanction in the form of a written warning will be imposed on the franchisor or franchisee, or both, that does not comply with the prospectus and franchise agreement registration requirements. The written warning will be served a maximum of three times: each warning will be served two weeks after the date of the previous warning letter.

A fine of up to 100 million rupiah will be charged if the franchisor or franchisee, or both, fail to respond to the registration requirements within two weeks of the third warning letter's expiry date.

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

Franchise law provides no remedy for the franchisee. Any remedy it wishes to have should be provided in the franchise agreement. Article 1338 of the ICC allows parties to a commercial contract to contract freely as long as the contract is made in good faith and satisfies the requirements of article 1320 of the ICC. Therefore, the parties can fashion their own remedies in the contract, subject to limitations in the law.

In the absence of contractual provisions to the contrary, general remedies available to a contracting party in the event of a breach of contract can arise from claims based on articles 1236, 1243 and 1267 of the ICC.

Article 1236 stipulates that the obligor is obliged to reimburse costs, losses and interest to the creditor if it has put itself in a situation whereby it is unable to deliver the goods or if it is unable to properly maintain the goods.

Article 1243 stipulates that compensation for costs, losses and interest due to non-performance of an agreement is only imposed if the obligor, after being declared in default, continues to fail to perform, or if it has to deliver or make the goods and such delivery or performance is performed beyond the agreed period.

Article 1267 states that the party against whom an agreement is breached can choose whether to force the defaulting party to fulfil its obligations (if this is still possible) or to request a termination of the agreement, accompanied by compensation of costs, losses and interest.

To avoid difficulties in calculating or proving damage, the franchise agreement may provide a certain amount of money to be paid to the non-defaulting party (article 1249 of the ICC). This means that the amount of compensation is agreed upon before actual losses are incurred. The consequence of such an agreement is that the agreed amount must be paid in the event of non-performance, regardless of the actual losses: in fact, no evidence is required to prove the losses. Under article 1249, the creditor can claim for performance of the obligation or for compensation, but not for both.

However, under article 1309 of the ICC, judges may reduce the agreed compensation if the contract has been partially fulfilled. Jurisprudence shows that judges have reduced the agreed compensation (even when there is no performance at all) on the basis of decency and good faith.

The law provides limitations as to what can be claimed as compensation. Compensation for default or non-performance is limited to losses that can be predicted and that are directly caused by the

default or non-performance (articles 1247 and 1248). Another limitation is with regard to moratorium interest. Moratorium interest is interest that must be paid (as a punishment) because the obligor is in default. Article 1250 of the ICC states that in agreements that solely relate to payment of money, the compensation of costs, losses and interest caused merely by a delay in payment shall only consist of payment of interest as determined by law, without prejudice to any specific regulation. Furthermore, article 1250 stipulates that compensation of costs, losses and interest shall only be paid from the day the claim is filed to the court to the day of payment thereof, unless otherwise determined by law.

Remedies specified in the contract are not the sole and exclusive remedies to which a party is entitled in the event of a breach. There are also provisions in the ICC that allow a party to claim for losses suffered outside any contractual relationship, namely, article 1365 of the ICC on negligence.

To our knowledge, few cases brought under article 1365 have been successful. In most cases, the court either rejects or partially accepts the claim: it agrees there is a tort but the amount of compensation cannot be fully justified. Also, claims under article 1365 cannot be combined with remedy under the contract or under article 1365.

Statutory liability for negligence is recognised in Indonesia. This concept is contained in both the Criminal Code and the ICC. The Indonesian Criminal Code separates crimes resulting from an intended action and those resulting from negligence. Article 1366 of the ICC states that any person will be liable, not only for any losses caused by his or her actions, but also for any losses caused by his or her negligence or carelessness.

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

There is no regulation on the sharing of liability. This should be agreed between the franchisor and the sub-franchisor. Individual officers, directors and employees of the franchisor or the sub-franchisor should not be exposed to liability unless there is negligence or fault on their part. However, in legal proceedings, they will usually be named as co-defendants.

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

The Indonesian Supervisory Commission on Business Competition (KPPU) Regulation No. 6 of 2009 on Guidelines for Exemptions from the Implementation of the Anti-monopoly Practices and Unfair Business Competition Law for Agreements Related to Franchises and the ICC. Also, see question 26.

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

There are no other general rules on pre-sale disclosure other than the franchise-specific rules on what disclosure franchisors should make to potential franchisees. As advised above, a franchisor must provide a prospectus disclosing its business data or information to a franchisee at least two weeks before the execution of the franchise agreement. We believe that the disclosure should cover franchise transactions. Please see question 17 for the minimum information that must be included in the disclosure document.

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

See question 20.

**Legal restrictions on the terms of franchise contracts and the relationship between parties in a franchise relationship**

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

Franchise law stipulates that the franchisor must provide assistance and guidance in the form of education and training on the management of the franchise, routine guidance in the operation of the franchise, assistance in developing the franchisee's market through promotion (advertising, catalogue, etc), and market and product research and development.

- 26 Do other laws affect the franchise relationship?

Franchises are exempt from the provisions of Indonesia's Antitrust and Unfair Business Competition Law (article 50B of Law No. 5 of 1999 on the Prohibition against Monopolistic Practices and Unfair Business Competition). The Indonesian Supervisory Commission on Business Competition (the Commission) has formulated franchise guidelines (Regulation No. 6 of 2009 on Guidelines for Exemptions from the Implementation of the Anti-Monopoly Practices and Unfair Business Competition Law for Agreements Related to Franchises (Guidelines)). The Guidelines serve as a clarification of article 50B that deals with matters relating to agreements for intellectual property such as franchising, licensing, patent, trademark, copyright, industrial designs, integrated circuits and trade secrets. Franchise agreements must not contain provisions that may result in monopolistic and unfair business practices. Other laws may affect the franchise relationship. If the franchise involves the importing of goods, import and export regulations are relevant. Trademark laws and other intellectual property laws may affect the franchise relationship.

Other specific laws that may affect the franchise relationship may include regulations on food registration and 'halal' certificates, regulations on modern markets (applicable to mini-markets, supermarket franchisees, hypermarkets and traditional markets), regulations on advertising, and Indonesian consumer law. The ICC will apply regarding the parties' general contractual obligations or when said obligations are not specifically regulated in the franchise agreement.

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

The Indonesian Supervisory Commission on Business Competition affects the franchise relationship. Indonesian domestic franchisors are consulted by or otherwise submit their views to the MOT on regulatory and policy matters concerning franchise.

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

In general, the parties should provide in the franchise agreement the circumstances that may give rise to termination of the franchise relationship. Under article 1266 of the ICC, a party may not unilaterally terminate an agreement without the consent of the competent court. Consequently, the franchise agreement should provide a clause waiving article 1266 of the ICC and allowing unilateral termination, by

reason of breach, default or any other reason. The franchise agreement may also be terminated with the consent of both parties.

- 29 In what circumstances may a franchisee terminate a franchise relationship?

See question 28.

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

As with termination, renewal rights and their terms and conditions should be provided in the franchise agreement. It would be prudent to provide in the agreement that the agreement expires on a certain date; then either party may request a renewal of the agreement by written notification to the other party three or six months prior to the expiry of the agreement. Automatic renewal is not recommended as it would be easy to miss the expiry date of the current term, which may mean that the agreement will continue under the same terms and conditions. The franchisor should provide that it may, at its sole discretion, refuse to renew. In the event of renewal, the parties will execute a renewal agreement based on terms and conditions agreed between them. Notwithstanding the foregoing, it is recommended that the discontinuation of the franchise relationship (either by termination or non-renewal, or otherwise) be made amicably with the aim of securing a clean break agreement or letter from the franchisee. This will pave the way for the franchisor to appoint a new franchisee, if required.

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

Yes, these rights should be specifically provided in the franchise agreement. Usually, these rights belong to the franchisor. The franchise agreement would normally provide that the franchisee may only transfer its franchise or undertake a transfer of ownership with the prior written approval of the franchisor. The aim is to ensure continuation of the franchise operation despite the transfer of the franchise or transfer of ownership in the franchisee entity.

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

There are no specific laws or regulations affecting the nature, amount or payment of fees.

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

The parties may provide in the agreement the amount of interest charged on overdue payments. The underlying principle is the good faith of the parties. It is possible for an aggrieved party to seek a reduction of interest if it believes the amount is not reasonable. The interest rate provided in a contractual agreement may exceed the interest rate provided by law (6 per cent according to Staatsblad Nederland – Indie 1848-22) to the extent that it is not in violation of the prevailing laws, regulations and public policy. There are no clear guidelines under Indonesian laws and regulations regarding the concept of public policy and, as explained above, Indonesian courts have interpreted the term public policy very broadly. Furthermore, it should be noted that:

- Staatsblad Nederland – Indie, which was published in 1938 (prior to the independence of the Republic of Indonesia), regulates matters related to usury. We understand that the Indonesian courts still recognise the applicability of this law, but we are not

aware of any case law in the Republic of Indonesia where the judges explicitly referred to this law as the basis for their decisions; and

- there is conflicting case law in the Republic of Indonesia regarding the high interest rates provided in contractual agreements. Some Indonesian court decisions have held that high interest rates must be reduced because, among other things, the rates stood against justice and humanity. Other court decisions have held that the high interest rates that have been agreed by the parties in a contractual agreement must be honoured by the parties.

It is worth noting that the Republic of Indonesia adopts a civil law system. Unlike the common law system, there is no necessity for a court to follow precedent. Each case is decided according to the presiding court's interpretation of the law and determination of the facts. It will be difficult to predict what interpretation the judges may take with regard to a specific matter such as this.

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

No, there is no law or regulation restricting the franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency. Nevertheless, please note the requirements related to the purchase of foreign currency against Indonesian rupiah discussed in question 4.

Even though this may not be relevant to the question, it is still worth noting that Law No. 7 of 2011 regarding currency (enacted on 28 June 2011) provides that Indonesian rupiah must be used for any payments, financial transactions or for the settlement of obligations in the territory of the Republic of Indonesia, except for:

- certain transactions for the implementation of the state budget;
- grants from or to Indonesia;
- international trade transactions;
- deposits in foreign currencies with Indonesian banks; or
- international financing.

Given this, the requirement to use Indonesian rupiah should apply to a sub-franchisee's payments to the master franchisee or sub-franchisor which we understand means payment that will take place in the Republic of Indonesia. Any violation of this requirement is subject to imprisonment for up to one year and a fine of up to 200 million rupiah. In addition, any recipient who refuses to accept payment in Indonesian rupiah for the settlement of financial transactions in Indonesia will be liable to up to one year in prison and a fine of up to 200 million rupiah, unless:

- they are in doubt about the genuineness of the money they have received;
- they have agreed in writing with the other parties to the agreement that the payment will be in foreign currency; or
- the payment is for one of the transactions in items in the previous paragraph.

- 35** Are confidentiality covenants in franchise agreements enforceable?

Yes, they are generally enforceable. The franchise agreement should provide that the franchisor will be entitled to certain damages or sanctions caused by violation of these confidentiality covenants.

- 36** Is there a general legal obligation on parties to deal with each other in good faith? If so, how does it affect franchise relationships?

Yes, the ICC provides that all agreements must be made in good faith. Article 1338 of the ICC states that 'all agreements validly entered into shall serve as law to the parties thereto. Such agreements cannot be withdrawn except by a mutual agreement of the

parties, or by reasons determined by law. Such agreements shall be implemented in good faith'.

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

Several laws contain provisions protecting consumers' interests, such as the Law on Hygiene, the Law on Goods, the Law on the Principles of Local Government, the Regulation of the Ministry of Trade on Direct Selling, Trading, etc, but consumers are not specifically defined.

The Law on Consumer Protection (Law No. 8 of 1999) defines consumers as users of goods and services for use by self, family, other persons or other living creatures that are not to be traded. The law further elucidates that consumers are end users of the products and services. As franchisees are business agents and not end users, they are not treated as consumers for the purposes of consumer protection.

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

The disclosure document and the franchise agreement may be in English. If they are made in a foreign language, an Indonesian version of the same must be prepared. As required under Regulation 53, the prospectus and franchise agreement must be translated into the Indonesian language by a sworn translator in Indonesia. Both the foreign and the Indonesian versions must be signed by the franchisor and franchisee.

Other than the language requirements under Regulation No. 42, Regulation No. 53 and Decree No. 138, it should be noted that Law No. 24 of 2009 on the National Flag, Language, Emblem, and Anthem enacted on 9 July 2009 (Law No. 24 of 2009) stipulates that the Indonesian language must be used in, among other things, agreements entered into by Indonesian parties. If the agreement involves foreign parties (such as a foreign franchisor and an Indonesian franchisee), the agreement can be executed in dual language (namely, using the Indonesian language and the language of the relevant foreign party or the English language). Further, Law No. 24 of 2009 provides that if a contract entered into by foreign and Indonesian parties is executed in dual language, all versions are the same as the original. Note that Law No. 24 of 2009 does not provide any sanctions for violations of the obligation to use the Indonesian language as described above or any further explanations of what is meant by all versions being the same as the original (given a dual language agreement).

Law No. 24 of 2009 provides that the details of this requirement will be further regulated in a presidential regulation and this implementing regulation may or may not provide sanctions for failure to fulfil the obligations imposed under Law No. 24 of 2009. Pending further clarification of Law No. 24 of 2009 in the presidential regulation, it appears that a number of leading commercial lawyers are of the view that unless required by law, the agreement may be in a language other than Indonesian (usually English). Therefore, it should soon be possible for contracting parties to agree that the English version of the agreement will prevail in the event of a dispute, particularly if it is the version negotiated by the parties. Given this, it is advisable that a clause clearly confirming the parties' agreement on this matter be inserted. With respect to franchise agreements, by policy of the competent government agency (namely, the Ministry of Trade), parties may register their franchise agreement executed in a foreign language. However, a translation of the agreement prepared by a sworn translator must also be submitted.

- 39** What restrictions are there on provisions in franchise contracts?

#### Term of the agreement

The regulations do not require a minimum term for a franchise agreement, and although the regulations state that the validity of the

**Update and trends**

According to a recent informal discussion with an MOT official, the Assessment Team under Regulation No. 53 has been established. It has 17 members, from various areas of expertise, and represents various elements such as business associations, market/industry experts, etc. It is also said that the MOT will issue a new technical regulation, the implementing regulation regarding the use of franchise logos and establish the Supervisory Team.

- market development assistance through promotions using advertisements, leaflets, catalogues, brochures or participating in exhibitions; and
- market research and development of products to be promoted, so the products meet the market's needs and are well accepted by the market.

The authorised agency will revoke the franchisor's certificate if the franchisor fails to carry out these obligations after receiving three consecutive warning letters.

STPW is five years, officials at the Ministry of Trade have advised us orally that a term of less than five years is acceptable and the STPW will be adjusted to mirror the term stated in the franchise agreement.

Early termination of the franchise agreement by the franchisor or master franchisee will not automatically enable the franchisor to appoint a new franchisee. Under Regulation 53, a STPW for the new franchisee will only be issued by the Ministry of Trade once the franchisor has settled all outstanding issues resulting from the early termination of the franchise agreement by the franchisor as evidenced in a written (clean break) agreement or a final and binding court decision.

**Governing law**

Regulation No. 42 no longer requires a franchise agreement to be governed by Indonesian law, but it must observe Indonesian law. However, Regulation No. 53 clearly states that a franchise agreement must be governed by Indonesian law.

**Business areas**

Except for provincial capitals, a franchise business may not be conducted unless the city or area has been 'opened' specifically for franchise activities by the Ministry. Again, this is to protect smaller enterprises. The precise location of franchise activities (whether in a traditional market or in a modern shopping mall) is also regulated, as is the ability to appoint franchisees for the same products or services on adjacent sites at a particular location.

**Training programmes**

Regulation No. 42 requires a franchisor to provide training programmes in the form of operational management assistance, marketing, research and sustainable development to the franchisee. The following are types of training programmes that should be provided by the franchisor to the franchisee under Regulation No. 53:

- an education and training programme regarding the franchise management system, in order to help the franchisee to operate the franchise in good order and to make a profit;
- routine operational management assistance, so any operational errors can be fixed immediately;

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

Indonesian competition law is not applicable to franchise relationships. However, the Indonesian Supervisory Commission on Business Competition has issued a guideline on franchising. See question 26.

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

The 1945 Constitution and relevant laws governing Indonesia's judicial system (for example, Law No. 48 of 2009 on the Competency of the Courts of Justice) have been designed so that the competency of the judiciary is performed by the Supreme Court and judiciary authority lies under its supervision as well as the Constitutional Court. The judiciary authority under the Supreme Court comprises the general courts, religious courts, military courts and the State Administrative Court. Unlike other courts, the Constitutional Court is not supervised by the Supreme Court.

In addition, Indonesia also recognises several specialised courts: the Commercial Court, which adjudicates bankruptcy petitions and trademark infringements; the Children's Court; the Human Rights Court; the Industrial Relations Court; and the Fishery Court that operate under the auspices of the general courts and the Tax Court that operates under the auspices of the State Administrative Court.

Commonly, a lawsuit is initiated by a plaintiff filing a complaint to the chairman of the district court located in the defendant's domicile. The plaintiff is then required to register the lawsuit with the deputy registrar of the appropriate district court. The losing party at the district court level is entitled to appeal to the High Court. It may take a year or more for the High Court's judgment to be rendered. A party that has lost a High Court decision may appeal to the Supreme Court. In these cases it can take three years or more for a final decision to be issued. Unless otherwise expressed in the relevant law, a panel of judges consisting of at least three judges, of which one is a presiding judge, will examine any lawsuit. The judgment must be delivered in open public court.

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As well as settlement of disputes through the courts, the parties may also settle their disputes by means of arbitration or alternative dispute resolution if they agree to it. The law defines alternative dispute resolution as an institution for settlement of disputes or divergent views through an out-of-court procedure agreed upon by parties, namely by means of consultation, negotiation, mediation, conciliation or evaluation experts. Foreign arbitral awards may also be enforced in Indonesia. The enforcement of an arbitral award, whether domestic or foreign, will require an execution order from the relevant court.

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

Theoretically, the principal advantages of arbitration for foreign franchisors are as follows:

- the confidentiality of disputes between the parties is guaranteed;
- procedural and administrative delays can be avoided;
- the parties can appoint an arbitrator who in their view has proper knowledge, experience and background in the disputed matters;
- the parties can determine the choice of law for dispute settlement, as well as the process and venue of arbitration; and
- the decision resulting from arbitration can be executed through a supposedly simple procedure.

However, there are certain disadvantages to arbitration over normal litigation: for example, while Indonesian arbitration law attempts to

reduce the potential for delays in the enforcement of arbitral awards, there is a distinct danger that the tight procedural timeframe for courts to hear appeals or for the disputing parties to prepare and make filings may result in hasty decisions and rushed drafting. Some uncertainty is also caused by some of the provisions of arbitration law (eg, the requirement for the parties to try to resolve disputes within 14 days prior to proceeding to alternative dispute resolution, although there is no further provision regarding when the 14-day period commences or whether it can be extended).

Another example is where a party wants urgent injunctive relief in the event of default by the defaulting party. In some contracts it is stated that one or both parties can go to the courts for such urgent relief. This has the obvious disadvantage that once a matter is before the court it is very difficult to cease the action and the party bringing the action will have to face counterclaims etc. Finally, as a matter of practice, we have to point out that it is often difficult to stop another party taking a dispute to the courts even though the parties have chosen arbitration as the exclusive dispute resolution mechanism.

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

Indonesian franchise law applies equally to foreign and domestic franchisors. Administrative requirements may differ, but in general, foreign and Indonesian franchisors are not treated differently.

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