



# Breach of Non-competition Clause in Franchise Agreements Related to Unfair Business Competition

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## Abstract

The non-competition clause in the franchise agreement is the franchisee's commitment not to run a similar business or potentially become a competitor to the franchisor's business within a certain period as a form of protection of the franchisor's intellectual property rights and appreciation for the transfer of know-how that the franchisor has carried out in the form of knowledge, concept, and experience to the franchisee. There are two purposes of this article. First is to explore and analyze cases of breach of the non-competition clause in franchise agreements in Indonesia carried out by franchisees can be qualified or not as a form of unfair business competition as regulated in Article 1 number 6 Law Number 5 of 1999 concerning Prohibition of Monopolistic Practices and Unfair Business Competition. Second is to investigate the legal remedies taken by the franchisor against the franchisee who breaks the non-competition clause in the franchise agreement. This research project uses qualitative method. This research involved respondents and informants from business owners of national franchisors. There are two results of this study. First, breaking non-competition clauses in franchise agreements, which have been read before signing, can qualify as unfair business competition. Second, if a franchisee or former franchisee breaks a non-competition clause, it is necessary to communicate with the violating party first before giving a summons/warning. Moreover, if it is still not heeded, the franchisor can file a lawsuit in court or submit a complaint to The Indonesia Competition Commission (KPPU).

**Keywords:** Non-Competition Clause; Franchise Agreement; Unfair Business Competition

## A. Introduction

Article 1 point 1 Government Regulation Number 42 of 2007 concerning Franchising stipulates that franchising is a special right owned by an individual or business entity for a business system with business characteristics to market goods and services that have been proven successful and can be utilized and/or used by other parties based on a franchise agreement. According to a general understanding, a franchise agreement is fundamentally a form of licensing development in the form of rights to use and employ a trademark or a

reputation owned by the franchisor. The provision of particular know-how on products can be included.<sup>1</sup> Based on Article 1 paragraph 8 Minister of Trade Regulation Number 71 of 2019 concerning Franchise Implementation, a franchise agreement is a written agreement between franchisor and franchisee. The granting of franchise rights is based on a franchise agreement, which according to Black's Law Dictionary, is:<sup>2</sup>

Generally, an agreement between a supplier of a product or service or an owner of a desired trademark or copyright (franchisor) and a reseller (franchisee) under which the franchisee agrees to sell the franchisor's product or service or to business under the franchisor's name.

Dealing with this understanding, it can be known that a franchisee also runs his own business by using the franchisor's trademark or service and by utilizing the franchisor's methods or procedures. In running the business, the franchisee employs the business system provided by the franchisor based on a franchise agreement. The agreement between the franchisor and the franchisee contains the rights and obligations of each party under the agreement they made.<sup>3</sup> The franchise agreement may contain provisions in which the franchisor requires the franchisee not to carry out the same business activities as the ongoing franchise businesses for a certain period after the expiration of the franchise agreement (non-competition clause).<sup>4</sup> Non-competition provisions in this franchise agreement may be exempted from Law Number 5 of 1999 concerning Prohibition of Monopolistic Practices and Unfair Business Competition (hereinafter referred to as the Business Competition Law) as long as they are intended to protect and/or relating to the Intellectual Property Rights (IPR) of the franchisor or to keep franchise identity and reputation.<sup>5</sup>

The Franchisee should comply with the non-competition clause's provisions in the agreed franchise agreement. For example, in the franchise agreement of K-24 Pharmacy, the following non-competition clause is regulated and agreed upon: The Franchisee hereby

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<sup>1</sup> Suyud Margono, *Hukum Anti Monopoli* (Jakarta: Sinar Grafika, 2013), 189.

<sup>2</sup> Gunawan Widjaja, *Lisensi atau Waralaba: Suatu Panduan Praktis* (Jakarta: PT RajaGrafindo Persada, 2002), 15.

<sup>3</sup> *The Decision of the Commission for the Supervision of Business Competition Number: 57/KPPU/Kep/III/2009 concerning Guidelines for the Implementation of the Provisions of Article 50 letter b of Law Number 5 of 1999 concerning Prohibition of Monopolistic Practices and Unfair Business Competition against Agreements Related to Franchise*, 1.

<sup>4</sup> *Ibid.*, 17.

<sup>5</sup> *Ibid.*, 18.

warrants and shall ensure that the Franchisee does not run any other business that is similar or potentially become a competitor of K-24 Pharmacy business during the Franchise Term and for a period of 3 (three) years after the Franchise Term ends. The implementation is that the franchisee of K-24 Pharmacy will not run and operate another pharmacy business during the franchise period, which is for 6 years and for 3 years after the franchise agreement ends.

This research aims to find out and analyze a breach of non-competition clauses in franchise agreements carried out by Franchisees, whether or not they qualify as a form of unfair business competition as stipulated in Article 1 number 6 of the Business Competition Law. In addition, this research also aims to identify and analyze legal remedies taken by franchisors against franchisees who break non-competition clauses in franchise agreements. Article 1 number 6 of the Business Competition Law defines unfair business competition as a competition between business actors who carry out production and/or marketing activities of goods and/or services dishonestly or unlawfully or hinder business competition. If cases of breach of the non-competition clause in franchise agreements in Indonesia carried out by franchisees can be qualified as a form of unfair business competition as regulated in Article 1 number 6 of Business Competition Law, so it becomes exciting and relevant to examine breaches of non-competition clauses in franchise agreements related to unfair business competition. It is in line with establishing the Business Competition Law as stated in Article 3 of the Business Competition Law, namely to prevent unfair business competition caused by business actors.

## **B. Discussion**

### **B.1. Breach of Non-Competition Clause in Franchise Agreements related to Unfair Business Competition**

The term franchise was previously unknown in Indonesian legal literature. It is understandable because the franchise has not originally existed in the culture or business traditions of the Indonesian community.<sup>6</sup> The term franchise has subsequently become a familiar term to the public, especially the Indonesian business community, and has attracted the attention of many parties to explore it. Furthermore, the franchise tried to be indonesianized

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<sup>6</sup> Sri Redjeki Slamet, "Waralaba (franchise) di Indonesia," *Lex Jurnalica* 8, no. 2 (2011): 325, <https://ejournal.esaunggul.ac.id/index.php/Lex/article/view/325>.

with the term "*waralaba*", which was first introduced by the Management Education and Development Institute (LPPM). *Waralaba* comes from the word "*wara*", which means more or special, and "*laba*", which means profit; hence, *waralaba* (franchise) means a business that provides more or special profits/benefits.<sup>7</sup>

Franchising is a business based on an agreement between two parties, i.e., a franchisor (right owner) and a franchisee (who accepts the right) to run the business of the franchisor according to the system determined by the franchisor.<sup>8</sup> In other words, franchising is a business arrangement in which a company (franchisor) gives rights to an independent party (franchisee) to sell the company's products or services under the rules set by the franchisor.<sup>9</sup>

Franchising actually relies on the ability of business partners to develop and run their franchise business activities through procedures, processes and a "code of conduct" and system determined by the Franchisor. Related to this franchise, it can be said that as part of the business partner's compliance with the rules of the game provided by the Franchisor, the business partner is given the right to utilise the Intellectual Property Rights of the Franchisor, both in the form of the use of trademarks, service marks, copyright on logos, industrial designs, patents in the form of technology, and trade secrets. The Franchisor then earns royalties for the use of their Intellectual Property Rights by the Franchisee.<sup>10</sup> PH. Collin in the Law Dictionary defines franchise as "a licence to trade using a brand name and paying a royalty for it" and franchising as "the act of selling a licence to trade as a franchisee". These definitions emphasize the important role of the trade name in franchising in exchange for royalties.<sup>11</sup>

The franchisor and franchisee certainly hope that through this partnership, they will gain greater profits and minimize the risk of failure. Franchisees employ the name, goodwill, products and services, marketing procedures, skills, operating procedures, and supporting facilities from the franchisor.<sup>12</sup> In return, the franchisee pays an initial fee and royalties (management service fees) to the franchisor as stipulated in the franchise agreement. A good

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<sup>7</sup> Adrian Sutedi, *Hukum Waralaba* (Bogor: Penerbit Ghalia Indonesia, 2008), 7.

<sup>8</sup> James A. Brickley, "Royalty rates and upfront fees in share contracts: evidence from franchising," *Journal of Law, Economics, and Organization* 18, no. 2 (2002): 511-535, <https://doi.org/10.1093/jleo/18.2.511>.

<sup>9</sup> Sutedi, *Hukum Waralaba*, 1.

<sup>10</sup> Widjaja, *Lisensi atau Waralaba*, 5.

<sup>11</sup> *Ibid.*, 14.

<sup>12</sup> Ilan Alon, "Global franchising and development in emerging and transitioning markets," *Journal of Macromarketing* 24, no. 2 (2004): 156-67, <https://doi.org/10.1177/0276146704269320>.

franchise package allows someone to operate a business successfully, even without prior knowledge.<sup>13</sup>

There are several advantages that the franchisees will obtain. First, they will get a big-name product or service from the franchisor. The success of the franchisor's business is a strong reason for franchisees to invest their funds.<sup>14</sup> Second, they obtain management training (marketing, production, finance, and Human Resources/HR). To make the business successful, the franchisor provides management supplies. Third, they get management assistance and promotion support.<sup>15</sup>

The object of the franchise agreement is the license, i.e., permission granted by the franchisor to the franchisee.<sup>16</sup> Trademarks/services are generally the main objects in a franchise agreement, although the rights granted are not limited to brands but may also include trade secrets, patents, and copyrights.<sup>17</sup>

A franchise is an exempt business subject Business Competition Law. It is regulated in Article 50 letter b of the Business Competition Law. In this case, there are two essential matters: whether the franchisee is prohibited from transferring the know-how (received) to other parties and whether to prevent the franchisee from acting fraudulently using the know-how obtained from the franchisor. Should the franchise agreement stipulate that the franchisee is prohibited to run the same business after the agreement ends?<sup>18</sup> Therefore, to prevent the franchisee from acting fraudulently using the know-how obtained from the franchisor, it must be stipulated in the franchise agreement after the agreement's end. The franchisee is prohibited to carry out the same business for a certain period because it could be that the intellectual property rights of the franchisee are the ones owned by the franchisor before; only the brand is different.<sup>19</sup>

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<sup>13</sup> Sutedi, *Hukum Waralaba*, 1.

<sup>14</sup> William E. Gillis and James G. Combs, "Franchisor strategy and firm performance: Making the most of strategic resource investments," *Business Horizons* 52, no. 6 (2009): 553-61, <https://doi.org/10.1016/j.bushor.2009.07.001>.

<sup>15</sup> Sutedi, *Hukum Waralaba*, 1.

<sup>16</sup> Zhanniza Elrian Angelita and I Made Tjatrayasa, "Syarat-Syarat Pembentukan Perjanjian Waralaba Berdasarkan Peraturan Pemerintah Nomor 42 Tahun 2007 tentang Waralaba," *Kertha Semaya* 3, no. 1 (January 2015): 3, <https://ojs.unud.ac.id/index.php/kerthasemaya/article/view/11903>.

<sup>17</sup> Ety Septiana Rahma and Ety Susilowati, "Kedudukan Tidak Seimbang pada Perjanjian Waralaba berkaitan dengan Pemenuhan Kondisi Wanprestasi," *Law Reform* 10, no. 1 (October 2014): 22, <https://doi.org/10.14710/lr.v10i1.12454>.

<sup>18</sup> Sutedi, *Hukum Waralaba*, 148.

<sup>19</sup> *Ibid.*, 155.

The non-competition clause in franchise agreements is the franchisee's commitment not to run a similar business or potentially become a competitor to the franchisor's business within a certain period as a form of protection of the franchisor's Intellectual Property Rights, appreciation for the transfer of know-how that the franchisor has carried out in the form of knowledge, concept, and experience to the franchisee. Applying non-competition clauses aligns with the commitment to realize fair business competition as stipulated by applicable legal provisions.<sup>20</sup>

Number 8 letter b point 2) Appendix I to Regulation of the Minister of Trade Number 71 of 2019 on Franchise Management also stipulates that the franchisee must maintain a code of ethics/confidentiality of Intellectual Property Rights or Business Characteristics provided by the franchisor. In practice, there were unscrupulous franchisees with bad intentions, namely establishing franchise partnerships with franchisors to get the know-how provided by the franchisor; then, before or after the end of the franchise agreement immediately setting up the same business/ potentially becoming a business competitor to the franchisor.

The World Franchise Council's Principles of Ethics in Chapter V – Termination of the Franchise stipulates the provisions: The termination provisions should protect the franchisor's know-how through appropriate non-compete restrictions on the franchisees.<sup>21</sup>

This research involved respondents and informants. The research respondents were five franchisors, whose Franchise Registration Certificates (STPW), and outlets were spread across several regions in Indonesia, and who implemented non-competition clauses in their franchise agreements. Franchisors, research respondents, consisted of Es Teller 77 Franchise, Melia Laundry & Drycleaning Franchise, K-24 Pharmacy Franchise, Kebab Turki Baba Rafi Franchisor, and Martha Tilaar Salon and Day Spa Franchise. Furthermore, the research sources were the Chairperson of the AFI/ Indonesian Franchise Association, Franchise Consultant, Legal Counsel, and Commissioner and Head of the Legal Bureau of the Indonesia Competition Commission (KPPU).

Anang Sukandar (Chairman of AFI/Indonesian Franchise Association) stated that business ethics in franchising must be developed. Franchise education is essential, including the non-competition clause, so there needs to be seminars and workshops related to franchising;

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<sup>20</sup> Arya Maheka, *Master Draft Perjanjian Waralaba Apotek K-24* (Yogyakarta: TP, 2013), 3.

<sup>21</sup> *The World Franchise Council's Principles of Ethics*.

make it an excellent habit. The franchisor must implement its code of ethics (foundation code of ethics). In this case, leadership and role models from the franchisor are needed. There needs to be continuous two-way communication between the Franchisor and the Franchisee, and enforcement is also required to see whether the provisions in the franchise agreement are enforceable/not.<sup>22</sup>

Utomo Njoto, as the Franchise Consultant, explains that ideally, there is a clear code of ethics, which can be accessed and upheld. However, in practice, the franchisee selection process is essential. The franchisee's character, potential, business experience, and financial condition determine the selection. Consideration matters to build business ethics in the world of franchising are the obligation for the franchisor to read and explain the terms of the franchise agreement before signing it to understand the rights and obligations of the parties.<sup>23</sup>

The parties' good faith in running a franchise business is crucial. It was disclosed by Grace Amelia, a legal consultant/counsel. The franchisor must realize that it is a franchise business (not a license), where the franchise business is not only related to the use of the franchisor's brand but also operational support, including system support (operational systems, Human Resources/HR systems, marketing, finance, administration, IT systems, and others). The parties, both the franchisor and the franchisee, need to understand well the rights and obligations of each. Franchisee ethics must comply with franchise agreement, Standard Operating Procedures/SOPs, and others.<sup>24</sup>

The formulation of an excellent non-competition clause in a franchise agreement needs to pay attention to several things. The provisions of the non-competition clause should be fair to the franchisor and franchisee. It is necessary to pay attention to its time (reasonable time limit: e.g., three years is the same as the non-competition clause applied in the insurance agent work agreement) and geography (no opening outlets in certain areas), which are then determined by the radius of how many kilometers.<sup>25</sup>

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<sup>22</sup> Interview with Anang Sukandar and Veronica Linda, Chair of the Indonesian Franchise Association. July 07, 2022.

<sup>23</sup> Interview with Utomo Njoto, Franchise Consultant. July 07, 2022.

<sup>24</sup> Interview with Grace Amelia Senggu, 2022, Legal Consultant. July 08, 2022.

<sup>25</sup> Interview with Anang Sukandar and Veronica Linda, Chair of the Indonesian Franchise Association. July 07, 2022.



The non-competition clauses should apply during the term of the agreement and be approximately two or three years (standard practice, benchmark from America and Malaysia) after the agreement ends. Meanwhile, the scope must be specific, not too broad. "Culinary" is an example of a too-broad scope, and "Meatballs" is a specific example. Non-competition is related to confidentiality and the definition/ reason for the existence of non-competition clauses.<sup>26</sup> An example of the formulation of a non-competition clause in a franchise agreement:<sup>27</sup>

If the franchisee does not continue the franchise agreement or terminates the franchise agreement sooner, the franchisee cannot run/ establish/ engage in any form related to a similar franchise business within one and a half years after the end of the franchise agreement with the franchisor.

The provisions of the non-competition clause bind the franchisee and are related to the location. If the location does not belong to the franchisee himself but leases, then in the rental agreement, the terms of the non-competition clause are agreed between the franchisee and the building owner. Franchisees may not provide support, either directly or indirectly, to their immediate family or affiliates to establish a similar business. In this case, the non-competition clause applies not only when the franchise agreement has ended but also during the franchise cooperation period between the franchisee and the franchisor.<sup>28</sup> Another example of the formulation of a non-competition clause in a franchise agreement:<sup>29</sup>

The franchisee, as a result of this, guarantees and is obliged to ensure that the franchisee, including his immediate family and affiliates (with direct or indirect support from the franchisor), does not run another similar business or potentially become a competitor of the franchise business (as a type of franchise business mentioned) as long as franchise period and for three years after the end of the franchise period.

The franchisor also needs to anticipate what sanctions should be regulated in the franchise agreement in the event of a breach of non-competition clauses. These sanctions due to breach of the non-competition clause include the imposition of fines related to the breach of the non-competition clause in the franchise agreement, termination of cooperation/revocation

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<sup>26</sup> Interview with Utomo Njoto, Franchise Consultant. July 07, 2022.

<sup>27</sup> Interview with Grace Amelia Senggu, 2022, Legal Consultant. July 08, 2022.

<sup>28</sup> *Ibid.*

<sup>29</sup> Maheka, *Master Draft Perjanjian Waralaba.*, 13.



of franchise rights, cancellation of the agreement, and compensation claims.<sup>30</sup> In principle, these sanctions can be termination or fines (determination of fines based on potential sales to be obtained, for instance), but does not eliminate non-competitive obligations. Hence, if there is a breach of the non-competition clause, the proposed solution is that the violating party must relinquish ownership of the business (with legal evidence and is linked to a commitment to confidentiality) or close the business that breaks the non-competition clause.<sup>31</sup> Fines under the mutual agreement, e.g., a compensation penalty for IDR 500,000,000.- (five hundred million rupiahs) is imposed by the franchisor against the franchisee if the franchisee breaks confidentiality, IPR protection, and non-competition. Sanctions for revocation of franchise rights are given if the breach of the non-competition clause occurs while the franchise agreement is still valid.<sup>32</sup> This non-competition clause remains in force (post-contractual) and can be held legally responsible even though the franchise agreement has ended.

All research respondents said the draft franchise agreement had been submitted to potential franchisees no later than two weeks before signing the agreement. It is intended so that no franchisee then gives an excuse that the franchisee is unaware of the non-competition clause in the agreement he has signed. Before signing the franchise agreement, the franchisor notified the franchisee of a non-competition clause and explained the consequences if the franchisor broke the non-competition clause. In this case, the franchise agreement was always read to the franchisee before signing it. The franchisee was given time to research the franchise agreement, then explain it.

The inclusion of a non-competition clause in the franchise agreement was considered necessary and effective by research respondents. As the owner of the Intellectual Property Rights (in the form of a brand) that was owned, indeed, it was the obligation and right of the franchisor to maintain and ensure that the prospective franchisee would not adopt the franchise business system in another business that was managed/owned by the franchisee, including his close family and affiliates.<sup>33</sup>

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<sup>30</sup> Interview with Anang Sukandar and Veronica Linda, Chair of the Indonesian Franchise Association. July 07, 2022.

<sup>31</sup> Interview with Utomo Njoto, Franchise Consultant. July 07, 2022.

<sup>32</sup> Interview with Grace Amelia Senggu, 2022, Legal Consultant. July 08, 2022.

<sup>33</sup> Interview with Eko Pratomo, Director of PT Melia Pilar Utama, Franchisor of Melia Laundry & Drycleaning. June 09, 2022.

Furthermore, the reason or motivation for breaking non-competition clauses in franchise agreements was that the franchisee felt capable of running the business without coordinating with the franchisor. Usually, the franchisee forgot about the non-competition clause in the franchise agreement.<sup>34</sup> Another reason was that franchisees saw opportunities to expand independently without the franchisor's support.<sup>35</sup> The franchisee imitated the franchisor's franchise business concept, including SOP, inventory/stock information, and so on, to get more benefits because they did not have to pay royalties. The franchisee wanted to be free from the conditions set by the franchisor.<sup>36</sup>

The non-competition clause in the franchise agreement is significant and risky if the non-competition clause is not included in the franchise agreement. If another party adopts the franchisor's business system, it will be very detrimental to the franchisor who has built his business from scratch decades earlier.<sup>37</sup> The inclusion of non-competition clauses in franchise agreements is vital to prevent conflicts and unfair business competition.<sup>38</sup> It is because there are still breaches, even though it has been stated in the franchise agreement.<sup>39</sup> In this case, the good faith and commitment of the franchisor in implementing the mutually agreed terms in the franchise agreement are absolute and critical. The inclusion of a non-competition clause in the franchise agreement is intended to protect the business concept including but not limited to SOPs and franchisor trade secrets.<sup>40</sup>

In Indonesia, it is necessary to regulate the inclusion of non-competition clauses in franchise agreements because it is vital to develop business ethics in this country. Non-competition clauses need to be included and must be enforceable. If the non-competition clause is not included in the franchise agreement, then the risk is that it is easily copied by other

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<sup>34</sup> *Ibid.*

<sup>35</sup> Interview with Hendy Setiono, Director of PT BABA RAFI INDONESIA, Franchisor of Kebab Turki Baba Rafi. June 28, 2022.

<sup>36</sup> Interview with Gideon Hartono, Director of PT K-24 Indonesia, Franchisor for K-24 Pharmacy. June 17, 2022.

<sup>37</sup> Interview with Eko Pratomo, Director of PT Melia Pilar Utama, Franchisor of Melia Laundry & Drycleaning. June 09, 2022

<sup>38</sup> Interview with Utamiwati (General Manager) and Pery Andiani (Business Development Manager) PT Cantika Puspa Pesona, Franchisor of Martha Tilaar Salon and Day Spa. June 28, 2022.

<sup>39</sup> Interview with Hendy Setiono, Director of PT BABA RAFI INDONESIA, Franchisor of Kebab Turki Baba Rafi. June 28, 2022.

<sup>40</sup> Interview with Gideon Hartono, Director of PT K-24 Indonesia, Franchisor for K-24 Pharmacy. June 17, 2022. Interview with Eko Pratomo, Director of PT Melia Pilar Utama, Franchisor of Melia Laundry & Drycleaning. June 09, 2022.

parties/ex-franchisees, and the know-how is directly used. In this case, it is very detrimental to the franchisor.<sup>41</sup> Legally, the non-competition clause needs to be stated (explicitly) in the franchise agreement. The paradigm of franchising must be the same. Franchising is not the same as entrepreneurship training.<sup>42</sup> The non-competition clause in the franchise agreement must be regulated both in laws and regulations and in the franchise agreement to provide protection and legal certainty for the parties, both the franchisor and the franchisee.<sup>43</sup>

All research respondents emphasized that if there was a breach of the non-competition clause in the franchise agreement, which had previously been read before it was signed, then the breach of the non-competition clause in the franchise agreement could qualify as unfair business competition. Breach of the non-competition clause could qualify as unfair business competition if the franchisee deliberately imitated the business.<sup>44</sup> Referring to Article 1 number 6 of Business Competition Law; unfair business competition is defined as competition between business actors who carry out production activities and/or marketing of goods and/or services dishonestly or unlawfully or hinder business competition. Based on these provisions, violating the non-competition clause in the franchise agreement can qualify as unfair business competition by the franchisee.<sup>45</sup>

Anang Sukandar, as Chair of AFI, also emphasizes that breaches of the non-competition clause in the franchise agreement can qualify as unfair business competition, which includes prohibited activities.<sup>46</sup> Meanwhile, Utomo Njoto, as the Franchise Consultant, stated that breaches of the non-competition clause in the franchise agreement, in principle, do not constitute unfair business competition. However, breaches of confidentiality aspects of information (mainly related to data, strategy, and business processes) were obtained due to franchise cooperation (not just aspects of IPR).<sup>47</sup> Grace Amelia Senggu, a legal consultant/counsel, explains that breaking the non-competition clause in the franchise

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<sup>41</sup> Interview with Anang Sukandar and Veronica Linda, Chair of the Indonesian Franchise Association. July 07, 2022.

<sup>42</sup> Interview with Utomo Njoto, Franchise Consultant. July 07, 2022.

<sup>43</sup> Interview with Grace Amelia Senggu, 2022, Legal Consultant. July 08, 2022.

<sup>44</sup> Interview with Andrew Nugroho, Director of PT Top Food Indonesia, Es Teller Franchise 77. June 07, 2022.

<sup>45</sup> Interview with Grace Amelia Senggu, 2022, Legal Consultant. July 08, 2022.

<sup>46</sup> Interview with Anang Sukandar and Veronica Linda, Chair of the Indonesian Franchise Association. July 07, 2022.

<sup>47</sup> Interview with Utomo Njoto, Franchise Consultant. July 07, 2022.

agreement can qualify as unfair business competition, based on the definition of unfair business competition. Several developed countries have regulated the provisions of non-competition clauses in separate franchise laws, e.g., the Netherlands, France, and England. In this case, it is necessary to regulate franchising in the law on franchising; hence, sanctions related to breaches can be regulated by criminal provisions, such as those related to IPR breaches. Due to several experiences of violating the non-competition clause and breaches of IPR, law enforcement has not been optimal because the punishment given to the violating party does not have a deterrent effect, only a suspended sentence.<sup>48</sup>

The Indonesia Competition Commission (KPPU) has many businesses competition supervisory agency tasks. Apart from the task of preventing and taking action against breachers of monopoly practices and unfair business competition to enforce the Business Competition Law, KPPU also carries out the duties as stipulated in Article 35 letter e of Business Competition Law, namely providing advice and considerations on government policies related to monopolistic practices and/or unfair business competition.<sup>49</sup>

The role of KPPU as a policy adviser on government policies affecting business competition is vital. This attempt is urgently needed considering that creating a fair business competition climate is a mandate of the Business Competition Law. As a business competition supervisory agency, KPPU must carry out its role.<sup>50</sup> KPPU, represented by Chandra Setiawan (Commissioner of KPPU) and Ima Damayanti (Head of Legal Bureau of KPPU), explains that based on/ using the rule of reason approach, if the breach of the non-competition clause in the franchise agreement is carried out dishonestly, for instance by says that the person concerned is a franchisee from the franchisor, the person concerned steals trade recipes, business concepts, etc, then the breach of the non-competition clause can be qualified as unfair business competition. In this case, it is necessary to pay attention to decency and fairness, and is significant to see that the franchisee defaulted/broke after the franchise agreement ended or before.<sup>51</sup>

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<sup>48</sup> Interview with Grace Amelia Senggu, 2022, Legal Consultant. July 08, 2022.

<sup>49</sup> Alston Chandra and Y. Sari Murti Widiyastuti, "Peran Komisi Pengawas Persaingan Usaha (KPPU) dalam Mendorong Iklim Persaingan Usaha yang Sehat di Sektor Perunggasan," *Justitia Et Pax* 33, no. 1 (June 2017): 8, <https://doi.org/10.24002/jep.v33i1.1416>.

<sup>50</sup> *Ibid.*, 9.

<sup>51</sup> Interview with Chandra Setiawan (Commissioner) and Ima Damayanti (Head of Legal Bureau), Indonesia Competition Commission (KPPU). August 01, 2022.

KPPU also explains the criteria employed by KPPU to assess the enactment/inclusion of a non-competition clause in a franchise agreement is an anti-competitive act or is still in the context of protecting and/or relating to the Intellectual Property Rights (IPR) of the franchisor or to maintain the identity and reputation of the franchise business. These criteria are contained in the Decree of the Commission for the Supervision of Business Competition Number: 57/KPPU/Kep/III/2009 on Guidelines for the Implementation of the Provisions of Article 50 letter b of Law Number 5 of 1999 concerning Prohibition of Monopolistic Practices and Unfair Business Competition in Agreements Relating to Franchise.

A non-competition clause is a requirement not to run a similar business within a certain period. In the franchise agreement, the franchisor requires that the franchisee should not carry out the same business activities as the franchisor for a certain period after the expiration of the franchise agreement. These conditions can be exempted from Business Competition Law as long as they are intended to protect and/or relate to the Intellectual Property Rights (IPR) of the franchisor or to maintain the identity and franchise reputation. If the non-competition clause is applied for an unlimited period, then the non-competition clause is not exempt from the provisions of the Business Competition Law.<sup>52</sup> The inclusion of a non-competition clause also occurs in the field of employment. For instance, KPPU employees within a certain period (one or two years) may not work in a lawyer's office related to KPPU (opposite from KPPU) in handling a case. Regarding the timeframe of one or two years, the time frame/ indicator is based on the following:<sup>53</sup>

1. Using the same technology or not.
2. The costs incurred to produce the product.
3. The nature of the franchise product has become a *public domain*/ property or not.

## **B. 2. Legal Actions Taken by a Franchisor Against a Franchisee who Breaks Non-Competition Clause in Franchise Agreement**

When a breach of the non-competition clause occurs, there are several actions taken by the franchisor, including the franchisor's reminder via a warning letter and notifying the consequences of violating the non-competition clause. If a breach still occurs, the franchisor

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<sup>52</sup> *Ibid.*

<sup>53</sup> *Ibid.*

will give the following *subpoena*/warning to submit a civil suit in state court. Other efforts made are, instead of giving a warning letter, a solution is needed if there is a breach of the non-competition clause after the franchise period ends, namely, ex-franchisees are allowed to continue business operations under their brand. However, with support from the franchisor (consulting and using franchisor products), in this case, the franchisor gets a license fee per year.<sup>54</sup>

The head of AFI says that if a franchisee or former franchisee breaks a non-competition clause, it is necessary to communicate first with the violating party. If there is no improvement, the franchisee or former franchisee must be given a summons/warning. Then, if it is still not heeded, the franchisor can file a lawsuit in court or submit a complaint to the Indonesia Competition Commission (KPPU).<sup>55</sup>

An amicable settlement needs to be sought when there is a breach of the non-competition clause, but the franchisor still needs to collect evidence. The franchisee or former franchisee is invited to resolve the issue (clarification and confirmation are carried out). When there is no improvement effort, the franchisor can send a warning/summons. The final effort due to no settlement is that the franchisor can file a lawsuit for default and/or a criminal report if the franchisee or former franchisee employs the exact Intellectual Property Rights (IPR), for instance, still using the same brand.<sup>56</sup>

Enforcement of non-competition clauses in franchise agreements that are not strong/weak will create a bad moral hazard and potentially lead to unfair business competition. The research results are expected to provide a reference and understanding of the parties' interests in the franchise agreement that need to be secured, particularly regarding intellectual property rights and the transfer of know-how, which must be respected to prevent unfair business competition by business actors. In addition, the results are expected to be a reference for subsequent studies on preventing unfair business competition.

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<sup>54</sup> Interview with Utamiwati (General Manager) and Pery Andiani (Business Development Manager) PT Cantika Puspa Pesona, Franchisor of Martha Tilaar Salon and Day Spa. June 28, 2022.

<sup>55</sup> Interview with Anang Sukandar and Veronica Linda, Chair of the Indonesian Franchise Association. July 07, 2022.

<sup>56</sup> Interview with Grace Amelia Senggu, 2022, Legal Consultant. July 08, 2022.

### **C. Conclusion**

Breaking non-competition clauses in franchise agreements, which have been read before signing, can qualify as unfair business competition. Breach of the non-competition clause can qualify as unfair business competition if the franchisee deliberately imitates the business. Based on the definition of unfair business competition (referring to Article 1 number 6 of Business Competition Law), breaking the non-competition clause in the franchise agreement can qualify as unfair business competition by the franchisee. Anang Sukandar, Chair of the Indonesian Franchise Association, also emphasizes that breaches of the non-competition clause in the franchise agreement can qualify as unfair business competition, including prohibited activities. The Indonesia Competition Commission (KPPU) describes that based on/using the rule of reason approach, if the breach of the non-competition clause in the franchise agreement is committed dishonestly, for instance, by saying that the person concerned is the franchisor's franchisee, the person concerned steals trade recipes, business concepts, and others, then the breach of the non-competition clause can be qualified as unfair business competition. If a franchisee or former franchisee breaks a non-competition clause, it is necessary to communicate with the violating party first. If there is no improvement, the franchisee or former franchisee must be given a summons/warning. Moreover, if it is still not heeded, the franchisor can file a lawsuit in court or submit a complaint to KPPU. Therefore, this research is expected to provide input to KPPU regarding breaches of the non-competition clause in franchise agreements that have the potential to qualify as acts of unfair business competition. In this case, it is necessary to optimize the implementation of the KPPU's duties in examining allegations of unfair business competition in society that is not or has not been regulated in the substance articles of the Business Competition Law in the context of creating a fair business competition climate as the mandate of the Business Competition Law.

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