

# Legal Protections of Trade Secret in Franchise Agreements: A Comparative Study with the United States and Australia

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## ABSTRACT

In the context of the franchise, franchisor automatically has approved the type of business undertaken by the franchisee; including trade secret is permitted to be replicated by paying royalties through agreement mechanism. But in the realities, there are the parties who commit to breach the contract. This research aims to analyze the legal protection granted to the trade secrets in the franchise agreement and comparative legal protection of trade secrets between Indonesia, the United States, and Australia. The method used in this research is normative research by conducting literature studies on legislation and other legal materials. The results of this research are the legal protections given to trade secrets in the context of the franchise agreement in Indonesia are divided into two: preventive and repressive protections. The protections are contained in several provisions one of which is, the provisions of Article 13 of Law No. 30 of 2000 on Trade Secrets as well as some related regulations. In the United States, there is the Uniform Trade Secrets Act and the Economic Espionage Act of 1996 which is used to protect trade secrets. Law enforcement of these provisions is very strict one of them is by way of confiscation of property resulting from the divulging of trade secrets. Furthermore, in Australia there is a justification in divulge of trade secrets so that it is not immediately can be categorized as a crime and law enforcement against the divulging of trade secrets is very strict. While in Indonesia there is no justification in the divulging of trade secrets.

**Keywords:** Protection, Trade Secrets, Agreement, Franchise.

## INTRODUCTION

The emergence of globalization trend in the economic field or trading is inevitable. The occurrence of globalization characterized by the increasingly transparent world. The sovereign of countries become indefinitely with other sovereign states of the world. It has to change the face of economic life around the world, including Indonesia. Economic globalization with free market will inevitably become part of daily life shortly (Nindyo Pramono, 2006:15).

One form of globalization is the development of franchise business which has already tuned to different countries, for example, McDonald, Kentucky Fried Chicken or KFC and so on. The number of franchise outlets opened by both small and

large entrepreneurs is a proof that foreign franchise business has penetrated into Indonesia. The franchise is used as a means to grow its business quickly.

Consequences of the franchise are franchise recipients may imitate or follow the type of business that has been done by the franchisor. This is preceded by the making of the agreement between the franchisee and the franchisor. The franchise agreement is made the franchisor has automatically agreed to the type of business that is allowed to be imitated by the recipient of the franchise by paying the royalties.

Under these conditions, in this case, the franchisor give permission to the franchisee to take advantage of Intellectual

Property Rights in particular, in which materialized in the form of brand or indication of origin specified and some form formatting, formulas, characteristic, methods, procedures, systems and so on that are peculiarly related to, and which can not be separated from any output or product produced and subsequently sold, delivered or traded using the trademark, service mark or indication of origin referred to above, which is called a trade secret (Adesia Adilman, 2010:15).

The granting of a franchise in respect of the grant of the right to use or exploit the intellectual property rights in the trade secret shall be kept confidential until at any time without limitation if such secrets are disclosed to the other party shall cause harm to the owner of trade secrets (Yunika Hadiani, 1). In reality, the execution of these trade secrets sometimes the parties commit acts to breach the contract to cause legal consequences, and if this occurs, of course, cause a dispute or a case (Amirah, 3).

This will certainly lead to losses for the franchisor because trade secrets are one key to the success of his business. In this regard, the Indonesian government provides some protection to the franchisor if it feels aggrieved due to the secrets of its merchandise used for the interests of the detriment of his party and not promised in the franchise agreement. This is a consequence of Indonesia as a member country of TRIPs. Likewise with the United States and Australia, which is a developed country in the protection of trade secrets and has several brands in the franchise to several countries.

The United States of America has several laws to protect trade secrets. This is to prevent fraud in trade secrets that lead to unfair business competition. Also in Australia, there are several principles and protections of trade secrets that are very different from Indonesia and interesting to be analyzed. Based on this the researcher is interested to analyze the legal protection of trade secrets in the franchise agreement which is compared with other countries,

namely the United States and Australia as the focus of this research.

## **RESEARCH METHODS**

This research uses normative legal research method that refers to the legal norms contained in legislation (Soerjono Soekanto and Sri Mamudji, 2004). Normative legal research is conducted through document studies on the laws and regulations, conventions, books, journals, theses and dissertations as well as other materials related to this research. The materials are then analyzed by the researcher.

## **RESULTS AND DISCUSSIONS**

A. Legal Protection Granted to the Trade Secret within the Context of the Franchise Agreement

### **1. Overview of Franchise in Indonesian Law**

Franchise was first introduced in Indonesia by the Institute of Education and Development Management. Amir Karamoy declares that legally a franchise means a legal agreement on the granting of a right or privilege to market a product or service from the owner or franchisor to another franchise recipient who is subject to certain rules (Amir Karamoy, 1996:3).

In Indonesian law, there are some provisions on the franchise include that is as follow:

- a. Government Regulation No. 16 of 1997 on June 18, 1997, about Franchise.
- b. Decree of the Minister of Industry and Trade No. 259/MPP/Kep/71997 dated July 30, 1997, about Provisions and Procedure for Registration of Franchise Enterprises
- c. Government Regulation Number 42 of 2007 about Franchise.

Furthermore on Government Regulation No. 16 of 1997 franchise is defined as follow:

"The engagement whereby either party is entitled to use and/or exercise the right to intellectual property or the discovery or characteristic of the business owned by

another party by a benefit under the terms and/or sale of goods and or services ".

Under this provision, there is an element involving the right to utilize and/or exercise the intellectual property right that characterizes the business. Intellectual property rights include trademarks, logos, designs, copyrights, trade secrets and patents that can be used by franchisees (Gunawan Widjaja, 2004: 49).

Furthermore, in this provision also emphasized that the grant of franchising is not given free of charge but by giving a reward. It is usually agreed in advance between the two parties. Concerning the agreement established by the franchisor and the recipient of the franchise must be contained in the Indonesian language and applicable to it in Indonesian law (Article 2 of the Decree of the Minister of Industry and Trade No. 259/MPP/Kep/1997 about the Provisions and Procedures for Registration of Franchise Enterprises). Such provision carries the consequence that the parties to the franchise agreement are not allowed to choose law. However, this provision is then experienced by the inclusion of Article 4 of Government Regulation No. 42 of 2007 on Franchising. In that article, the franchisor and recipient must pay attention to Indonesian law.

## **2. Trade Secrets in a Franchise Business**

A system, method or format has certain characteristics that often become the core of the success of the franchise. This characteristic becomes sought by consumers so that consumers can choose to buy the product. In a franchise business, the uniqueness or characteristic is kept secret in such a way. This is because the information has an economic value related to the resulting product (Muhammad Faisal, 2012:47).

Additionally, the owner of the franchise was also in conducting the franchise agreement, trying hard to keep their trade secrecy. In practice, misuse of trade secrets often occurs in the franchise business. An example is the leaking of trade secrets

involving former franchise recipients or former workers who open new businesses and compete with franchisees that have many similarities such as components, products, services or operating standards owned by franchisors (Mark S. Vanderbroek, 2006). So this requires legal protection to prevent harm to certain parties.

Furthermore, the trade secret itself began to be developed in the nineteenth century. One of the most important cases in trade secrets is the case of Prince Albert vs. Strange. The case occurred in 1849 which was essentially Queen Victoria, and Prince Albert had a penchant for painting on metal. This is done by the queen because of hobbies and intended for personal use although sometimes given to his friends as a memento. At one time the painting was handed over to a silent expert of graves who then handed over to the defendant for commercialization. The court ruled that the defendant was guilty of breaching the confidentiality contained in a contract (Rahmadi Usman, 2003: 381).

The concept of a trade secret is information that includes, patterns, aggregations, data information, programs, methods, tools, techniques, processes that have economic value because it is not known by the public and still strived to be kept secret. While regarding the purpose of trade secrets are intended to spur investment and utilization of information that ensures long-term profits as well as short-term profit (Rahmadi Usman, 2009:25).

In a franchise business practice, information that can be categorized into trade secrets consisting of four that are:

- a. Financial Information  
For example: Internal cost structure, pricing information, salary and compensation plans, price list
- b. Commercial Information  
For example: Commercial list, business plan, marketing strategy, supplier arrangements, customer buying preferences and requirements, consumer profiles, sales methods.

c. Technical and Scientific Information  
For example: Biological inventions, designs, drawings, patterns, motifs, test data, laboratory notebook, formulas, photographic process.

d. Negative Information  
For example: details of the failed effort to remedy problems in the manufacture of certain products, dead-ends in research, unsuccessful attempts to interest costumers in purchasing a product.

Based on the teaching materials contained in the World Intellectual Property Organization (WIPO) website, trade secrets contained in the franchise business may include the following (Guribal Singh Jaiya, 2007):

"Financial, technical, structural, marketing, engineering, distribution techniques or documents, recipes, business formats and plans, operations manuals, customer list and printing techniques are all candidates for protections as trade secrets. Franchisors develop, use and license confidential and proprietary computer software in their system. And also any improvements or enhancements to the business, generate valuable data that may be developed by the franchisee."

### **3. Legal Protection of Trade Secret in Franchise Agreement**

Legal protection of trade secrets in franchise agreements is essential. It is due to protecting the franchisor from fraudulent conduct by franchisors or third parties committing commercialization without permission. Forms of legal protection of trade secrets in the cooperation agreement franchising or grouped into the form of preventive and repressive form of action or measures adopted after their legal consequences (Amirah, 9).

The repressive effort, in general, is done by way of formation contract or agreement of vital importance in the assembly of legal relations in the form of rights and obligations agreed upon by the parties of the business parties. The purpose of a contract or agreement is to create legal

certainty and justice for both the parties making it and for the third party. Therefore a contract or agreement must be made by the rules of contract and with applicable law (Amirah, 9).

The franchise agreement established is one aspect of the legal protection. This is because the treaty can be a strong legal basis for enforcing legal protection for the parties. If one party violates the contents of the agreement, then the other party may sue the infringing party by applicable law. The franchise agreement contains a set of terms, conditions, and commitments made and desired by the franchisor for its franchisees.

However, in the implementation, the protection of trade secrets in the context of franchise agreements still has many obstacles. One of them is the parties have not understood the legal aspects of the franchise, so it does not have good guidelines. This condition may have an impact on the protection of trade secret laws in franchising since business actors are not aware of the importance of such intellectual property right protection as the core of a franchise. The ignorance of the franchise can be seen in the preparation of franchise agreements, where in the franchise agreements, there are no special clauses about the protection of intellectual property rights of the franchise. Thus there will be a weakness of the franchise agreements, which will very likely be exploited by certain parties that results in legal matters, in particular violations of intellectual property rights, such as trade secrets under a franchise (Adesia Adilman, 2010: 100).

In addition to the forms of legal protection against the franchise also affirms in Indonesian law which explicitly in the Act No. 30 of 2000 about Trade Secrets, Law No. 14 of 2001 on Patents, Act No. 15 of 2001 on Marks and Law No. 19 of 2002 on the Right Copyright and Government Regulation No. 42 of 2007 on Franchises in which regulate the criteria of business that can be franchised. In Law No. 30 of 2000 on trade secrets, it is expressly stated that:

"The violations of trade secret occurs when people intentionally disclose trade secrets, breaks the agreement or the obligation, written or unwritten to keep the trade secrets concerned."

Based on the provisions of the article as mentioned above, in Indonesian law, trade secrets are protected by the provisions of Article 13 of Law No. 30 of 2000 on Trade Secrets. However, there are exceptions to the opening of trade secrets regarding:

- a. Disclosure action of trade secret or use of public security, health or safety defense.
- b. Product reengineering actions were resulting from the use of other people's trade secrets made solely for further development of the product concerned.

It is preventive protection. While the repressive action with a written warning on contract or agreement that has been agreed or signed by the parties asserted that if the franchisee violates provisions or agreements that have been agreed are not directly and immediately decided the contract of cooperation, but in advance shall be given warning in writing in a row as much as 3 (three) times, and if it is found to be ignored, the next step taken by the franchisor is to terminate the agreement and termination of the contract (Amirah, 10).

Termination of this contract or agreement is one of the steps or actions taken by one of the parties if the other party defaults apart from the claim of compensation. Also, criminal prosecution is allowed when one party has committed a crime. Termination of the contract or an agreement may also be made if one of the parties no longer honor or deliberately violates the provisions of this agreement, and does not remedy after 2 (two) written warnings by the other party (Amirah, 10).

Furthermore the franchise business law ideally to protect the interests of the parties but the reality not necessarily match as expected. As stated by Roscoe Pound which divides 3 (three) classes that must be

protected by law, that is, public interest, social interest and personal interest (Satjipto Rahardjo, 1982: 266). However, an economically stronger franchisor position will also give effect to the operation of law in the community. Law has a strong position because the conception of providing an opportunity to the country's comprehensive or the Government to take the necessary measures to bring the public to the desired destination in and poured in regulation made (Meylan Maringka, 2013:87).

## B. Comparative Legal Protection of Trade Secrets in Franchise Agreement between Indonesia, the United States, and Australia

### 1. Protection of Trade Secrets in Franchise Agreements in the United States

In American terms, a franchise is defined as a concession (Adrian Sutedi, 2008:6). Franchises began to be known more or less two centuries ago when beer companies licensed small companies to distribute their products. The franchise system in the United States first began in 1851. At that time, the United States arose in what is called the first generation American franchise system, referred to as straight product franchising or pure production franchise.

After World War II, in the United States developed a second generation franchise system, called the entire business franchising. In this growing system, the covenant bond is no longer just about one aspect of production but tends to cover all aspects of the operation of the franchisor. The franchisor to bring the achievement of the franchisee a form or decorating a place of business, the concept of corporate policy and management system or organization. Franchisor directs and "melds" the franchisee into a system that the franchisor has set (Adrian Sutedi, 2008: 2).

Regarding the law in franchise in America there are various laws that govern the provision of the Federal like as in Title 16, Chapter 1 of the Federal Trade

Commission (FTC), Sub Chapter D Part 436 on Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, as well as in-state rules based on the Uniform Franchise and Business Opportunities Act (UFBO) (Adesia Adilman, 14). However, not all countries have a law about franchise. Franchise settings are often based on civil, commercial and social law of each country (Pan Lindawaty, 2009: 30).

Furthermore, in the franchise business also knows some things that have the potential to be trade secrets, among others, as follows:

- a. A business system, formats or methods;
- b. Franchise manual;
- c. Business plans and strategic information;
- d. Product information, recipes and formulas;
- e. Customer and supplier information;
- f. Prospective franchise information;
- g. New product development plants; and
- h. Proprietary computer software and technology.

In practice, these criteria to be regarded as trade secrets still depend on the jurisdiction and laws prevailing in a country where proof of trade in a trade secret is required. This is very important because to prove that the criteria are classified into trade secrets (Mark S. Vanderbroek, 2006: 192).

This California law not only requires the franchisor be liable for damages or losses suffered by franchisors for the submission of false information, but the franchisee is also given the right to claim the franchisor if the franchise is canceled or terminated unilaterally by the franchisor. The recipient of a fraudulent franchise may claim compensation from an individual (either an individual or a business entity) in association with the franchisor in the event that the franchisor is in a judgment proof position (without sufficient assets to be considered for indemnification), or the giver

of the franchise has been declared bankrupt (Martin Mandelshon, 1997) .

Furthermore, in the development of American law, the protection of trade secrets undergoes periods of challenge and conflict. On the one hand, the US Government strongly encourages openness towards the top invention of technology that technological invention will be sustainable. On the other hand, there are many applications that are rejected or canceled by court decisions that have hurt the disclosure party.

In those times there was no clear provision or rule on the protection of undisclosed information. One of the most widely used provisions is Article 757 Restatement of Torts 1978 (Gunawan Widjaja, 2004: 28-29). Based on the need for a comprehensive provision of trade secret protection it was then established the Special Committee on the Uniform Trade Secret Act.

In addition to the comments given in the National Conference of Commissioners of Uniform State Laws stated that what is deemed appropriate in the acquisition of information concerning trade secrets are:

- a. The discovery of information which undisclosed by independent inventors;
- b. The discovery of information that undisclosed through reverse engineering. In reverse engineering, one works in reverse starting from a known product then experimenting to find the manufacturing process.
- c. Acquisition of undisclosed information under license from the party entitled.
- d. Discovery through the process of observation in a public exhibition;
- e. Obtaining information through published media.

Based on such matters, obtaining information through licenses or franchises concerning trade secrets is deemed as a worthy thing. Whereas if such information is obtained by any means other than those as mentioned above then it is considered an

improper matter and may be subject to a civil penalty or charge. Besides that in American law also there are some obligations to protect trade secrets. It gives the implication to form a secrecy agreement as a preventive measure.

In addition to the Uniform Trade Secrets Act, the regulation of trade secrets in American law is also contained in The Economic Espionage Act of 1996 or often referred to as the EEA which contains misuse of trade secrets. The enforcement against the EEA is so serious. In this Act, some of the detailed rules of infringement and theft in trade secrets include the provision of a court settlement.

In this case the court has an important position in the determination of information that can be categorized as trade secrets. In some cases, the American Court is of the opinion that information is still regarded as confidential although it has been disclosed to licensees or franchisees or other third parties during and as long as it is done with a limited purpose. Furthermore, trade secret owner must also take the steps necessary to keep the confidentiality of information that has been disclosed, for example through secret agreements and not to make use beyond what has been permitted. Furthermore, trade secrets and confidential status can be lost if the information contained in it disclosed for example in the form of a patent application, in a publication, conferences, exhibitions.

## 2. Trade Secret Protection Settings in Franchise Agreement in Australia

Several cases recorded in Australia reveal that trade secrets will change the confidentiality when placed on the internet. In principle "once a trade secret is posted on the internet, it is effectively part of the public domain, impossible to retrieve." It also means that trade secrets will become public property when it is posted on the internet.

Also there is a justification for defense as well as other cases. The most prevalent thing in Australian law enforcement is the defense of the public

interest. In this case, for example, is a case of disclosure of trade secrets from alcohol gauges contained in the driver's body in the UK. In this case, the employees of the detector manufacturer revealed in the newspaper that doubts the work of the tool supported by the data.

The tool that is considered inaccurate has been used by the police, and its test results have been used as a basis to determine the error of a person for being considered drunk and unfit to drive a vehicle. Employee action is legally justified and is not considered a trade secret violation. This is due to the public interest (Henry Soelistyo, 2004: 133).

Other forms of defense such as a person's ignorance of the confidentiality of information because it is not informed or no clear instructions but the confidentiality of the information. In principle are honesty and good faith. Cases concerning this may occur if a person uses a trade secret without being notified that the information provided is a trade secret.

While in its enforcement Australia provides an opportunity to the disadvantaged persons or parties to the disclosure of trade secret information through the civil suit of trade secrets. Of particular importance is that in violation of Australia's trade secrets law recognizes sanctions in criminal and civil. The civil judgment usually involves a court order to stop the use of trade secrets and compensation or a combination of both (Henry Soelistyo, 2004: 134).

The court's decision regarding the order of the defendant to terminate the use of trade secrets may be requested if there are strong grounds for violating trade secrets. This is to prevent greater losses suffered by the owners of trade secrets resulting in such violations.

In the verdict the court usually considers the actual forms suffered. An example is the loss of profit gained (account of profit) associated with the loss of market share. In many cases of trade secret violations, the plaintiff feels aggrieved by

the loss of monopoly power, market domination, and the necessity of unfair competition. Often plaintiffs also demand compensation for the destruction of the reputation for trade secret violations (Henry Soelistyo, 2004:134).

The offense is also very possible in violation of trade secrets caused by the franchise granting by the franchisor. Sometimes the franchisor uses the trade secret for personal gain after the franchise contract expires or the leak of trade secrets by employees in the franchise business considering the numerous and highly vulnerable employees for the disclosure of secrets.

In some countries, the court distinguishes between employees' obligations to maintain their trade secrecy while working and after the termination of employment contracts. During employment, an employee is usually bound by loyalty to his employer that prevents employees from using any information that may harm the employer's interests (Tim Lindsey et al, 2006: 252).

## **CONCLUSION**

Based on the discussion and analysis that has been done by the researcher there are several conclusions in this paper namely:

a. Legal protection granted to trade secrets in the context of franchise agreements in Indonesia is divided into two: preventive and repressive protection. Repressive protection is in some provisions one of which is in the provisions of Article 13 of Law No. 30 of 2000 about Trade Secrets as well as some related regulations such as the Trademark Law, Copyright Law and so on. Also there are several Government Regulations about Franchise that include minimum standards contained in the franchise agreement. While the repressive effort is through a reprimand or termination of contract agreements. It is used to protect trade secrets that are particularly vulnerable to leakage in the context of franchise agreements.

b. Legal comparison the protection of trade secrets between Indonesia, America, and Australia are in the United States there are the Uniform Trade Secrets Act and the Economic Espionage Act of 1996 which is used to protect trade secrets. Law enforcement of these provisions is very strict one of them is by way of confiscation of property resulting from cheating trade secrets. While in Australia there is a justification in the disclosure of trade secrets so that it is not necessarily that the disclosure of trade secrets is a crime.

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