Franchise 2018

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Chile

Cristóbal Porzio
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Overview

1 What forms of business entities are relevant to the typical franchisor?
A distinction must be made between franchisor and franchisee. In fact, a franchisor may or may not incorporate a company in Chile for the governance of its local operation. If a decision is made to incorporate a company, general rules applicable to Chilean companies will apply without any particular disadvantage or handicap arising from being a foreign franchisor (shareholder of the company to be incorporated in Chile). In this respect, Chilean law does not discriminate against foreigners, who are treated as locals.

In addition, from a tax standpoint, the establishment of a local branch or subsidiary in Chile could be beneficial, not only for deducting any expenses paid in Chile, but also if the country of origin of the franchisor is a signatory to a double taxation treaty with Chile.

On the franchisee’s side, practice indicates that most franchisees decide to use an existing legal structure or to incorporate a new legal entity for the purpose of developing franchising activity in Chile. In the case of brand new entities incorporated by the franchisor for the new operation, the franchisor will in most cases request from the franchisee, in addition to the execution of the agreement, a personal guarantee, considering that the new entity will not have assets or turnover to guarantee the operation.

2 What laws and agencies govern the formation of business entities?
The Civil Code, the Commercial Code and special laws, such as the Law of Corporations and the Law of Limited Liability Companies, will govern the formation of business entities. The Tax Code and special tax laws will also apply.

As far as entities are concerned, the Registry of Commerce and the Service of Tax Collection (SII) are to be cited. In addition, for some companies, mainly large corporations, a special authority, the Superintendency of Corporations, will oversee the correct functioning of the corporation.

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

Formation of a business entity
The main steps and requirements for the formation of a business entity are the following:
• drafting the by-laws or statute of the company in the form of a public deed and execution of the document, by the partners, associates or shareholders, before a notary public;
• drafting an abstract of the by-laws;
• publication of the above draft abstract in the Official Gazette;
• registration of the abstract with the Registry of Commerce;
• obtaining a fiscal number from the tax authority (SII);
• payment of tax with the local municipality for the right to supply services and operate the company; and
• opening of accounting books.

Maintaining a business entity
For the maintenance of a business entity, the following requirements will need to be complied with:
• payment of taxes to the local municipality every semester;
• payment of VAT on a monthly basis;
• payment of the annual taxes on profits;
• keeping accounting books and company books; and
• complying with local laws, especially in relation to tax, employment and social security.

4 What restrictions apply to foreign business entities and foreign investment?
Foreign entities are allowed to operate in the Chilean market. Before doing so, they will be required to register with the SII, to bring the capital they will use in Chile by means of one of the routes established by the Statute on Foreign Investment, to pay taxes in Chile as a local company and, finally, to export benefits out of Chile on prior payment of withholding tax (WHT).

5 Briefly describe the aspects of the tax system relevant to franchisors. How are foreign businesses and individuals taxed?
In general terms, outbound payments made by a Chilean taxpayer to foreign companies or entities are subject to 35 per cent WHT. However, this rate is reduced depending on the legal nature of the payment (ie, royalties are subject to 30 per cent tax). Payments by means of a franchising contract would be dealt as royalties for Chilean tax purposes.

As of 2017, Chilean taxpayers may choose from two different tax systems regarding income generated by domestic companies: the attributed income system (AIS) and the semi-integrated system.

Attributed income system
Under this system, Chilean taxpayers will be subject to Chilean corporate tax, first category income tax (FCIT), at a rate of 25 per cent at the source level. In addition, local resident shareholders or partners are subject to a global complementary tax (GCT), with a progressive rate (maximum 35 per cent), and non-residents are subject to WHT at 35 per cent, applied on an accrual basis. This system allows final taxpayers to use full tax credit for the FCIT paid by the source entity. This regime is applied by default to individual entities with limited responsibility, one-person enterprises, and limited liability companies or sole traders.

Semi-integrated system
Under this system, Chilean taxpayers will be subject to FCIT at a higher rate than the AIS system (55.5 per cent for 2017 and 27 per cent from 2018). Local resident shareholders or partners subject to GCT and non-residents subject to WHT (the ‘final taxpayers’) will be subject to taxes on a cash basis, when profits are distributed or withdrawn from the entity. Final taxpayers will only be able to use 65 per cent of the FCIT paid by the source entity. As a consequence of the above, the overall tax burden may reach 44.45 per cent. Therefore, under this system shareholders will still be able to defer taxation on WHT applied on profits generated by the source companies until these are distributed, but with the right to use a lower tax credit for the FCIT paid. This system will be applied to all other entities that do not fall under the AIS by default.
Non-resident taxpayers
Please note that non-resident taxpayers who reside in a country with which Chile has a DTA in force will be entitled to use the full FCIT paid by the source as a credit against WHT. Therefore, in this case the tax burden should not exceed 35 per cent.

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?
A labour relationship will be established once the following elements are put together: a labour contract, a link of ‘subordination and dependence’ and the existence of rules on the place and time that the work will have to be executed.

Therefore, in order to avoid or at least reduce the risk of the franchisor being considered the employer of the employees of the franchisee, it will be necessary:
• to avoid participating in the business entity of the franchisee;
• to take care to include in the franchising contract a clause stating very clearly that the employees of the franchisee are not related to the franchisor;
• to include in the franchising contract a clause stating that the franchisee will have to comply on a periodical and regular basis with all the rules and duties regarding social security, the latter being an essential obligation of the franchisee;
• to manage very carefully the educational programmes given by the franchisor to the employees of the franchisee; and
• if the franchisor were to send one or more of its employees, especially at the beginning of the operations for ‘a programme to teach the concept of the brand, management of same and management of the store and software’, to take special care establishing such a programme in writing with the franchisee, implementing the programme with a representative of the franchisee and clearly limiting the duration of the programme.

7 How are trademarks and know-how protected?
The Chilean Constitution provides for the protection of the right to private property, the right to develop economic activity and for the protection of intellectual creations.

The Industrial Property Law (Law 19.039) provides for the protection of the different types of industrial property, including trademarks, industrial designs, drawings, patents, trade secrets, geographical indications, etc. In addition, Chile is a member of the Paris Convention. In order to obtain trademark protection in Chile, it will be necessary to file a trademark application with INAPI (the Chilean Patent and Trademark Office) according to the procedure established in the Industrial Property Law, until registration is granted. A trademark registration will last for 10 years from the date of the grant and will be renewable for periods of 10 years.

Even if the registration of a trademark is not mandatory for using a trademark in Chilean territory, the franchisor will need to register its trademarks in Chile in order to avoid any risks of infringement by third parties and to manage the Chilean project amicably. It is also highly advisable to include in the franchising contract, in addition to a section on intellectual property, a licence agreement for the use of the franchisor’s trademarks. This licence agreement will need to be registered with INAPI for the franchisee to be able to enforce the trademark rights in Chile, and to protect the brand.

Trademark registrations granted by INAPI are not vulnerable to cancellation on the grounds of non-use. Know-how will be typically protected by means of clauses regarding know-how and trade secrets included in the franchising agreement. In addition, this agreement should clearly state the levels of confidentiality the franchisee will have to request from its employees during the life of the labour contract and also following termination (the latter will be for a specific period). The franchisee’s labour contract the with its employees should clearly reflect this fact.

The Intellectual Property Law or Copyright Law (Law 19.336) provides for the protection of copyright. This is especially important in the case of franchising for software, architecture, manuals, etc. In addition, Chile is a member of the Berne Convention.

8 What are the relevant aspects of the real estate market and real estate law?
Freedom of contract and market pricing applies. Therefore there are no legal limitations on foreigners or foreign companies buying or renting a facility, except in border areas (which are normally non-urban) and for agricultural use.

Real estate operates on the basis of registered property and transfer of title must be made through a public deed and subsequent registration in the real estate registry of the city where the property is located. Leases may be carried out through private documents, though for the purposes of certainty and validity, in the case of sale of the property or death of the lessor, a public deed and corresponding registration of the lease contract with the registry are strongly recommended. Lease agreements of urban properties are partially regulated by Law No. 18,101, but there is still ample scope for the parties’ individual discretion.

Laws and agencies that regulate the offer and sale of franchises

9 What is the legal definition of a franchise?
Chilean legislation does not provide for a special law on franchising. Thus, Chilean law does not give a definition of franchising.

In spite of this, franchising agreements in force in Chile will be ruled by the Commercial Code, by the Civil Code and more particularly by the ‘law of the contract’. In other words, what the parties (ie, franchisor and franchisee) will have agreed in writing will be their ‘law’ for the duration of the contract. Thus the main applicable law will be the contract executed by the parties, since the contract is to be considered as law for the parties. In fact, article 1545 of the Chilean Civil Code states: ‘Any contract legally executed is law for the parties [...]’. In addition, the Civil Code states in article 1546: ‘Contracts must be executed in good faith, and therefore in consequence submit the parties not only to what is written in the contract, but also to what comes from the nature of the obligation [...]’. There is no doubt that such a provision refers to contracts that have been executed by the parties and that are in force.

10 Which laws and government agencies regulate the offer and sale of franchises?
As indicated in question 9, there is no Chilean franchising law. In addition, franchising contracts are private documents and are not be registered by the parties with any public authority or government agency.

11 Describe the relevant requirements of these laws and agencies.
Not applicable (see questions 9 and 10).

12 What are the exemptions and exclusions from any franchise laws and regulations?
Not applicable (see questions 9 and 10).

13 Does any law or regulation create a requirement that must be met before a franchisor may offer franchises?
No. In fact, a franchisor can offer franchises in Chile at any time, independently of having done business in Chile before the offer. The franchisor will be obliged to comply with the law of the contract. In addition, if the franchisor were to have a structure or legal entity in Chile, the franchisor would also have to comply with Chilean laws as far as its branch or subsidiary is concerned.

In the case of a lack of local structure, and as far as local laws are concerned, it is necessary to add a word regarding taxes. The franchisor will be entitled to receive all amounts produced by the Chilean operations (rents considered as having their origin in Chile). The franchisor will have to pay WHT on these amounts (that will need to be withheld and paid by the franchisee, on behalf of the franchisor) at the time of taking its profits out of Chile.

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?
No. The franchisor will simply need to comply with Chilean laws and with the concept of public order.
15 What is the compliance procedure for making pre-contractual disclosure in your country? How often must the disclosures be updated?

Considering that there is no franchising law in Chile, the form, terms and timing of pre-contractual disclosure will be determined and decided exclusively by the franchisor. In addition, once first contact is made with the potential franchisee(s), the parties agree on the pre-contractual disclosure agreement that could revoke any broader disclosure than the one initially in the franchisor’s mind at the time of making the first approaches.

In conclusion, the matter will have to be examined on a case-by-case basis, with the parties free to decide on how they will operate. The leverage of the franchisor on what to disclose will mainly depend on the strength of its brand and existing network. In addition, local practice indicates that even if the law does not provide for obligations or requirements, comprehensive disclosure will in most cases facilitate the understanding of the parties and will also facilitate the reaching of an agreement or, on the other hand, simply accelerate termination of the negotiations. Finally, as all types of contract have to be negotiated and entered into in good faith according to the provisions of the Civil Code, even if the type of disclosure is as indicated above, the franchisor will have to disclose in good faith, even pre-contractually.

16 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 rules indicated in question 15 will also be applicable in this case. The master franchisee will in most cases treat the sub-franchisee as if it were the franchisor. In the case of a master franchising agreement (MFA), it is expected that the MFA will include one or more provisions concerning this matter.

17 What information must the disclosure document contain?

Local practice indicates that disclosure documents used in Chile are standard and similar to the ones used overseas. In fact, since local law does not provide for any specific rules for franchising agreements or for pre-contractual documents, the franchisor will be bound by good faith and in consequence do its best to give to the potential franchisee as much information as necessary to make a decision and become a franchisee.

18 Is there any obligation for continuing disclosure?

No, basically for the same reasons as indicated above.

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

Not applicable.

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?

In view of the lack of law on franchising, there is no special rule on this matter, so the general rules of the Civil Code will apply. Among these rules, we can highlight the provisions regarding the establishment of consent, good faith, the fulfilment of obligations, etc.

In the case of fraud, the Criminal Code will apply.

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?

The same provisions outlined in question 20 will apply to the sub-franchisee.

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?

Generally speaking, Chilean law will consider the parties that are to enter into a commercial agreement or contract as equals. In consequence, it does not impose more pre-contractual obligations that those that are the result of the application of the principle of good faith. In this respect the Civil Code states that ‘contracts must be executed in good faith’. Under this normal arrangement, the parties to a contract will only have to comply with the requirements of pre-contractual disclosure that are needed to ensure that both parties are acting in good faith (ie, to prove that the information granted to the other party was as necessary to execute the contract freely and under its usual meaning).

The obligations of the parties at the time of negotiating the agreement are not specifically established and therefore franchising contracts are to be treated like any other commercial contract. Thus what was discussed at the time of the negotiations will in principle have little effect or value unless it is possible to prove that the discussion was not a simple discussion but an oral agreement that was taken before the execution of a final document and towards the execution of such final document.

In this respect, article 1554 of the Civil Code states:

The promise to enter into a contract does not produce any obligation, except if the following occurs:

(a) that the promise is made in writing;
(b) that the contract promised is not of one of those that the laws declare ineffective;
(c) that the promise contains a term or condition that sets the time of conclusion of the contract; and
(d) that the promised contract is specified in such a manner that the only missing elements for its perfection are the handling of the good (object) or the solemnities prescribed by the laws.

In addition, articles 1560 to 1566 of the Civil Code contain rules for the interpretation of contracts. Some examples are:

- if the intention of the parties is known, it should be considered more important than the literal words of the contract;
- the terms of the contract, even if they are general, will be applied only for the contract;
- the interpretation of a clause that produces effect will be preferred over an interpretation that does not;
- unless a clear intention of the parties against it, the contract should be interpreted in the way it better fits its nature;
- the clauses of common use are considered part of the contract even when they are expressly included; and
- the clauses of a contract should be interpreted in a way that favours the complete execution of the contract.

Therefore, at the time of offering and selling a franchise, the franchisor will need to be as transparent as possible. This does not mean that at the first contact everything is to be disclosed. But a memorandum of understanding (MOU) setting out the clear intentions of the parties and a clear timeline to be followed will be advisable. The MOU as such will not be easy to enforce (ie, it will hardly permit the franchisor to force the potential franchisee into a final franchising contract). However, clear and forceful clauses regarding the timeline to be followed, with milestones to be accomplished, confidentiality, non-competition, etc, are of the essence of an MOU and should be enforceable in case of infringement. In addition, as far as the timeline is concerned, if the negotiations are fruitful and it is necessary to have more time for the execution of the final franchising contract, it would be advisable to execute a promise of a franchise, leaving to the execution of the final franchising agreement only the fulfilment of a condition or arrival of a fixed and expected deadline.
31 May a franchisor restrict a franchisee’s ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?
Yes. In fact, franchising agreements tend to be considered as intuitions personae (ie, in consideration of the active participation of a particular natural person or persons) contracts and therefore, if the contract does not provide for a right for the franchisee to transfer, a special agreement between the parties will be needed.

32 Are there laws or regulations affecting the nature, amount or payment of fees?
No.

33 Are there restrictions on the amount of interest that can be charged on overdue payments?
Yes. The laws ruling bank operations set a maximum rate of interest that can be charged.

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. The foreign currency market is an open market that the franchisee can access freely through any bank operating in Chile.

In addition, at the time of sending money abroad the franchisee will have to justify why the money is being sent. Depending on why a payment is being made, WHT may also apply.

35 Are confidentiality covenants in franchise agreements enforceable?
Yes.

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. See question 22.

37 Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?
No.

38 Must disclosure documents and franchise agreements be in the language of your country?
No. The contract is a private document and agreement between two parties. It can be written in Spanish or in a different language, provided the two parties understand the language in which the contract was written.

In some practical cases, the parties may decide to use one specified language and have a sworn translation in a different language at the same time. In most cases of this nature, the contract will indicate that one of the languages will prevail in case of discrepancy.

Please note that if the forum chosen by the parties for dispute resolution were to be the Chilean courts, a contract in Spanish would be more than advisable.

39 What restrictions are there on provisions in franchise contracts?
Possible restrictions in a franchise contract will be those written and agreed by the parties to the contract. If the two parties act in good faith and are older than 18, they will be allowed to execute any kind of franchise agreement, as long as it complies with Chilean legal order, public security and ‘good habits’. Although Chile has a very open liberal market economy, below we comment on some matters that are often discussed at the time of negotiating a franchising agreement in Chile.

Duration
The duration of franchising contracts usually varies in Chile depending mainly on the brand, type of goods or store, and investment to be made in Chile for the development of the business. However, what is quite common in practice is the stipulation of an automatic renewal clause in case none of the parties were to inform the other of the intention not to renew, once the first term of three, five or seven years is close to expiry.
Territory
The territory of Chile is very large, the distances very important and the major cities would be the first point of interest for establishing a franchised business. Exceptions could be the business of convenience stores, of pharmacies, of private post offices, for which even very small towns in Chile might be of interest to a franchisor. Practice indicates that most franchising agreements give a franchisee the complete territory of Chile, including duty-free shops in ports and airports. In these cases, the right to sub-franchise is rather common.

Still, regarding territory, exclusivity or non-exclusivity will be a question of negotiation and agreement between the parties.

Restrictions on source of goods
In this respect, please note that the Industrial Property Law contains a specific provision authorising the parallel import into Chile of legitimate goods. Therefore, a special clause will need to be carefully drafted in this respect in any franchising agreement.

Applicable law and courts
According to Chilean law, the parties to a contract can submit the contract to foreign courts. The same can be said on the right of the parties to decide to submit their disputes to foreign courts. Practice indicates that there is no general rule in Chile in this respect. In the case of submissions to Chilean courts, it is very common to see arbitration as a solution and especially the designation of the Arbitration Center of the Chamber of Commerce of the city of Santiago, which is prestigious and well known in Chile and in Latin America.

40 Describe the aspects of competition law in your country that are relevant to the typical franchisor. How are they enforced?
Franchise agreements are not subject to special treatment under Chile’s competition law. Therefore general rules will apply. Among these, we can especially mention the Antitrust Law (DL N° 211 of 1973) and the Unfair Competition Law (Law N° 20,169 of 2010). In contrast to the general Chilean legal system, the legal system ruling antitrust and unfair competition gives a very special role to case law, which is examined, studied and applied in court decisions.

As far as legal provisions are concerned, some parts are worth citing:

Any person that enters into or executes, individually or collectively, any action, act or convention that impedes, restricts or hinders competition, or sets out to produce said effects, will be sanctioned [...], notwithstanding preventive, corrective or prohibitive measures that may be applied to said actions, acts or conventions in each case.

The following will be considered as, among others, actions, acts or conventions that impede, restrict or hinder competition or that set out to produce said effects:

(a) Express or tacit agreements among competitors, or concerted practices between them, that confer on them market power and consist of fixing sale or purchase prices or other marketing conditions, limit production, allow them to assign market zones or quotas, exclude competitors or affect the result of bidding processes.

(b) The abusive exploitation on the part of an economic agent, or a group thereof, of a dominant position in the market, fixing sale or purchase prices, imposing on a sale another product, assigning market zones or quotas or imposing other similar abuses.

(c) Predatory practices, or unfair competition, carried out with the purpose of reaching, maintaining or increasing a dominant position.

In general, an act of unfair competition is any act against good faith or good custom that, by illegitimate means, is carried out with the purpose of diverting the clientele of a market agent.

The Unfair Competition Law contains a merely illustrative list of behaviour considered as ‘acts of unfair competition’. Among others:

- any conduct that takes advantage of another’s goodwill, or that aims to confuse a third party’s goods, services, activities, distinctive signs or establishment with those of the infringer;
- the use of signs or spreading facts or assertions, incorrect or false, that lead to misinformation about the nature, provenance, components, characteristics, price, production process, brand, appropriateness in fulfilling objectives, quality or quantity, and in general about the advantages that are really provided by the offered goods or services; and
- any incorrect or false information or assertion about the goods, services, activities, distinctive signs, establishment or commercial relations of a third party that is capable of harming its goodwill or any expression directed to discredit or ridicule such person without any objective basis.

41 Describe the court system. What types of dispute resolution procedures are available relevant to franchising?
See questions 39 and 42.

42 Describe the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction.
Arbitration is very often seen in franchising contracts in Chile. This applies to contracts where all the parties are Chilean and also to contracts where the franchisor is a foreign company.

Arbitration is expensive compared with an action before the ordinary courts. However, a procedure before an arbitrator should be faster than one in the ordinary courts. In addition, the arbitrator should have more experience than an ordinary civil judge in new contracts and in business matters where time is of the essence in solving disputes, and when collateral damage is to be minimised.

As far as local arbitration is concerned, see question 39.

43 In what respects, if at all, are foreign franchisors treated differently from domestic franchisors?
There is no discrimination between foreign and domestic franchisors.