IBA/IFA 33rd ANNUAL JOINT CONFERENCE

INTERNATIONAL FRANCHISING COMMITTEE

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INTERNATIONAL FRANCHISING IN A CHANGING WORLD

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LOI, TERM SHEETS, MOU'S AND OTHER INTERIM DEAL DOCUMENTS IN INTERNATIONAL FRANCHISE TRANSACTIONS

May 9-10, 2017

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Interim Deal Documents [1]

Franchisors have continued to expand into international markets in recent years as the global economy has become more connected and brand recognition has flowed across borders. International expansion can further complicate the already complex negotiations of a typical franchise agreement as the parties will have to navigate differing business, legal, and cultural landscapes. The first step for many franchisors is often negotiating a letter of intent, term sheet, memorandum of understanding or other interim deal document. [2] Such interim deal documents can provide considerable value in agreeing on material terms, setting expectations, and providing a roadmap for the transaction before engaging in extended negotiations of a franchise agreement. Setting expectations upfront in an interim deal document can be especially helpful in an international context where the local business community may be less familiar with the franchising model or where the franchisor may be less familiar with local business practices.

1. Binding or Non-Binding Agreement?

The threshold question with an interim deal document is whether it should be a binding or a non-binding agreement. This decision will be driven by the business purpose – do the business principals view the interim deal document as just a commitment to negotiate further or an actual commitment to a transaction? In most cases, it is the former. Accordingly, it is common to enter into non-binding interim deal documents in order to agree on key terms as a precursor to further negotiations. In addition, at the stage of an interim deal document, the parties are typically still evaluating the transaction and each other and may not wish to be held to a binding agreement just yet.

[1] The authors would like to thank Nixon Peabody LLP attorney Nia Newton for her assistance with this article.

[2] In this paper we mostly use the term "letter of intent" or "LOI" and in doing so we refer to all interim deal documents.

2. Certain Binding Terms in a Non-Binding Agreement

In the context of a non-binding interim deal document, franchisors will often provide that certain terms will be binding. Candidates for binding terms typically include terms on confidentiality, trademarks, and applicable law.

Confidentiality covenants in interim deal documents are important to protect the inappropriate use and disclosure of the franchisor's confidential and proprietary information, regardless of whether or not the parties progress beyond the interim deal document. Even if the parties do not enter into a franchise agreement, any confidential or proprietary information to which the prospective franchisee has become privy during or after negotiation of the interim deal document should be protected.

As a franchisor's trademarks are essential elements of its brand, franchisors should consider including a binding provision regarding trademarks. The interim deal document should be clear that it does not grant a license to the prospective franchisee to use the franchisor's trademarks. It should state that the prospective franchisee has no rights to use the trademarks unless and until a franchise agreement is entered into and then only pursuant to its terms.

A binding applicable law provision should be included in an interim deal document in the event of any disputes arising relating to the interpretation, compliance and performance of the document.

3. Negotiating Non-Binding Interim Deal Documents in Good Faith

A potential risk of entering into a non-binding interim deal document is that, in the event of a dispute, a court could imply a duty of good faith and find that the interim deal document is binding. Parties can mitigate this risk through careful drafting of clear language to reflect the parties' intent. In some cases, franchisors will expressly include a duty to negotiate in good faith in their interim deal documents with a view to signing a binding document by a certain date. This approach raises the negotiating standard and will make it more likely that the interim deal document is viewed as binding.

In entering into non-binding interim deal documents in common law jurisdictions, franchisors should be aware of the risk that a court could find an interim deal document binding based on its assessment of the parties' intent. This paper later reviews these issues in a civil law context.

Most courts in common law jurisdictions will attempt to determine the intent of the parties from the language in the interim deal document. Courts will attempt to assess whether there was a "meeting of the minds". Franchisors can attempt to mitigate the risk of a court finding that a non-binding agreement was intended to be binding or a court implying a duty of good faith by including clear language to indicate the intent of the interim deal document. Of course, as attorneys know, drafting to prevent future interpretations is sometimes easier said than done. At a minimum, the language in a non-binding interim deal document should expressly state which terms are binding. The interim deal document should state that a party will not be in breach of the interim deal document or liable to the other party as a result of a failure to enter into the franchise agreement. To go a step further, the interim deal document could state that there is no obligation, express or implied, to negotiate in good faith toward a binding agreement and that any party may terminate negotiations at any time for any reason or no reason.

Franchisors should be cognizant that their conduct could be reviewed in determining an intent to be bound by a non-binding interim deal document. Generally, under common law contract principles, the conduct of the parties should not be admissible to determine the intent of the parties as courts will rely on the text of the interim deal document. Nonetheless, if the conduct of a party conflicts with the terms of the interim deal document, then there is a practical risk that the conduct could potentially serve as a basis for a finding of intent. For example, carrying out actions under an interim deal document prior to signing the franchise agreement could be viewed as an intention to be bound by the interim deal document. Such a determination would be made on a case by case basis depending on the facts in each situation. If there are actions that a franchisor would customarily undertake after signing an interim deal document whether or not the parties progress to a franchise agreement, such as performing due diligence on a prospective franchisee, it is helpful to include language in the interim deal document that such actions are not evidence of an intent to be bound by the terms of the interim deal document.

Alternatively, franchisors wishing to expressly include an obligation to negotiate in good faith in their interim deal documents should realize that such an obligation raises the standard and makes it more likely that a non-binding document will be viewed as binding. Before including such language, a franchisor should confirm that it is consistent with its business practices since such language would limit the ability of the franchisor to terminate negotiations regardless of the reason.

4. Most Important Terms to be Included in an Interim Deal Document

In deciding what terms to include in an interim deal document, franchisors should provide enough information for a prospective franchisee to evaluate the deal but should take care not to provide so much detail that it frustrates the purpose of making the negotiation process more efficient. A helpful exercise in striking this balance is to consider what terms are essential and what terms may be deal killers if not raised until the first draft of the franchise agreement. In countries without franchise disclosure requirements, more information may be necessary in the interim deal document if it would otherwise not be available to the prospective franchisee.

The following is a good example of a set of terms to include in an interim deal document:[3]

- Major business points such as price and territory
- Anticipated due diligence
- Anticipated critical path for the transaction and anticipated closing date
- Confidentiality obligations and allocation of the cost of negotiations and documentation
- What type of documentation will reflect the final deal
- Termination rights and any breakup fees

The major business point that is top of mind for most parties will be the fees due under a franchise agreement. The interim deal document should address fees, both any initial fees such as an application fee or a deposit, as well as recurring fees throughout the term of the franchise agreement, such as royalties. Other system fees and charges, such as any advertising or group funds, should also be addressed. The interim deal document should clearly state

[3] Steven Goldman, Gaylen Knack, Jorge Mondragon, and Andrew Loewinger, *Using Letters of Intent, Term Sheets and Other Interim Deal Documents in International Franchising* in IBA/IFA 26th Annual Joint Conference, May 18-19, 2010 at 3.

whether each fee or charge is refundable or not and under what circumstances. The goal should be that a prospective franchisee understands from the interim deal document the total "all-in" fees and charges for which they will be responsible under the franchise agreement and the related payment terms. This will facilitate the prospective franchisee's evaluation of the transaction and its ability to effectively move forward in negotiations.

In addition, if any additional security or a guaranty will be required, this should be addressed in the interim deal document as well. If the determination regarding additional security or a guaranty will be made at a later date, it is helpful to at least raise the concept in the interim deal document so that the prospective franchisee can appreciate the full universe of potential financial commitments.

Other major business points would include the term of the franchise agreement and whether there will be any renewals (whether automatic or discretionary), the territory, performance criteria and compliance with system standards, and sources of required products or operating systems.

In international interim deal documents, it is advisable to include terms regarding the currency for payments, foreign exchange, and treatment of taxes as these matters can become complex across borders and require strategic planning for the parties. If there will be a gross-up for withholding taxes, that requirement should be included in the interim deal document as well.

5. Applicability of Franchise Laws

When a franchisor decides to expand its business internationally, there are a number of legal questions that must be addressed before the franchisor and a prospective franchisee sign a franchise agreement on the dotted line. In the beginning stages of any international franchise transaction, a franchisor must determine what, if any, laws and regulations will apply to its franchise agreement in the foreign country and whether those laws will also apply to the pre-contractual negotiations and agreements it enters into with its prospective franchisee.

Franchising currently exists in over 150 countries and an increasing number of those countries have implemented laws that regulate franchise transactions. Countries like Brazil, Belgium, France, Germany, Spain, Sweden, Taiwan and United States (federally and in several states) have franchise disclosure laws. Angola, Estonia, Lithuania, Kazakhstan, Kyrgyzstan, some U.S. States, Russia, and Ukraine all have franchise relationship laws. Argentina, Australia, China, Canada (the provinces of Alberta, British Columbia, Manitoba, New Brunswick, Ontario, and Prince Edward Island), Indonesia, Italy, Japan, Macau, Malaysia, Mexico, Romania, South Korea, several U.S. States, and Vietnam have implemented both franchise disclosure laws and franchise relationship laws. There are also a number of countries who have bodies of law (e.g., commercial agency, competition, distributorship, intellectual property, tax, etc.) which may cover certain portions of a franchise transaction. Depending on the country, province, or state, a franchisor may be required to register its franchise or provide disclosure before it begins any preliminary negotiations with a prospective franchisee. Franchisors are strongly advised to seek the advice of local counsel in their target country before offering franchise opportunities. Failure to discern legal idiosyncrasies that could trigger disclosure and/or registration requirements, like the definition and terms associated with franchising in the jurisdiction, the payment of a deposit or fee, or the multi-jurisdictional aspects of a deal, may result in a franchisor's violation of an applicable franchise sales law.

5.1 Considerations

(i) Definitions and Language in Franchise Laws and the Execution of

an LOI

The definitions and language used in a country's franchise sales law addressing when disclosure or registration is required can be so broad as to encompass most or all of a franchisor's preliminary agreements with a prospective franchisee, or it can be so narrow as to apply solely to the franchise agreement. Some countries may have franchise sales laws that vary in their definitions of terms like "franchise," "offer," "contract," etc. Accordingly, a franchisor must consider whether its preliminary agreements or negotiations fall within the definitions or terms of its target country's franchise sales laws before proceeding with any franchise offers or activity.

For example, in Taiwan, the Principles for Handling Cases Relating to the Operation of Franchisors ("Principles") require a franchisor to provide a prospective franchisee with a disclosure document in writing 10 days, or a reasonable time period as the case may require, before the franchise or "preparatory franchise relationship" has been "established." A preparatory franchise relationship is defined as the relationship established before the franchisor and prospective franchisee enter into a formal franchise relationship. The Principles deem a preparatory franchise relationship "established" once the counterparty pays certain fees or expenses and executes franchise-related documents (including preliminary agreements, a letter of intent, a memorandum of understanding, etc.) and the parties agree in such franchise-related documents that the fees or expenses paid by the counterparty will be confiscated or the counterparty will be liable for damages in case of withdrawal.[4]

In countries like Brazil, the applicability of a franchise law to a letter of intent may be more straight-forward. For example, Article 4 of Brazil's Franchising Law requires a franchisor to furnish a Franchising Offering Circular to a prospective franchisee 10 days prior to the execution of a "preliminary franchise agreement" or the payment of any kind of fee by the prospective franchisee to the franchisor.[5] "Preliminary franchising agreement" includes letters of intent or options to purchase franchise rights in Brazil.

In the United States, franchisors should be especially careful, as they are legally bound by a somewhat two-tiered regulatory system. For example, unless franchisor's franchise transaction is exempted under the Amended FTC Rule,[6] ("FTC Rule") a franchisor will be bound by the FTC Rule and its franchise disclosure obligations. However, the franchisor's obligations may not end at the federal level. A franchisor will also be bound by franchise sales laws and regulations in those states that have implemented them. In certain cases, a state's franchise sales laws could subject franchisor to more stringent disclosure requirements, obligate the franchisor to register its franchise offering, and dictate portions of the franchisor's relationship with its franchisees and prospective franchisees.

Under the FTC Rule, a franchisor is required to provide a prospective franchisee with a disclosure document at least 14 calendar days before the prospective franchisee "signs a binding agreement with, or makes any payment to, the franchisor or an affiliate in connection with the proposed franchise sale." The scope of disclosure required under the federal rule is quite broad, as it applies to any binding agreement or any payment in connection with a proposed franchise sale. That said, there may be some solace in knowing that a franchisor that enters into a non-binding letter of intent that requires no deposit or other payment may, arguably, not be required to provide disclosure. And, further, given that there is generally no private right of action for disclosure failures under the FTC's Franchise Rule, there may be relatively low risk in entering into such a preliminary agreement. Nonetheless, if that same franchisor is offering a franchise opportunity to a prospective franchisee who resides in New York, the franchisor will be

[4] Andrew P. Loewinger and Michael K. Lindsey, *International Franchise Sales Laws*, 476-498 (American Bar Association 2d ed. 2015).
[5] The Franchising Law (Law 8.955) 1994 (Brazil) Article 3.
[6] (Federal Trade Commission)16 C.F.R. Part §436.

required to register under the New York General Business Law and be subject to New York's disclosure requirements mandated to apply to "all written or oral arrangements between a franchisor and franchisee in connection with the offer or sale of a franchise, including, but not limited to, the franchise offering, the franchise agreement, sales of goods or services, leases and mortgages of real or personal property, promises to pay, security interests, pledges, insurance, advertising, construction or installation contracts, servicing contracts, and all other arrangements in which the franchisor or subfranchisor has an interest."[7] Under New York's Business Law "offer" of a franchise is defined as "any attempt to offer to dispose of, or solicitation of an offer to buy, a franchise or interest in a franchise for value." Ultimately, while it may be arguable or ambiguous under Federal law whether a franchisor has to provide disclosure before entering into a non-binding preliminary negotiation or agreement, if its deal is conducted or its prospective franchisee resides in a certain state that regulates franchise activities, the franchisor should be well aware of that state's requirements and ensure that it is in compliance with both federal and state obligations.

There will be certain jurisdictions that require disclosure or registration before the start of franchise sale activities or otherwise concluding the sale of the franchise. Some jurisdictions may require franchisors to register within a certain time period after an initial or each franchise sale. As the scope of international franchise sales laws varies depending upon the jurisdiction and the jurisdictions' definition of key franchise terms, franchisors must research and review each such law and regulation individually to ascertain the impact of such laws and regulations on its preliminary agreements. [8]

(ii) Payments and Deposits

Requiring a prospective franchisee to make payments or a deposit in connection with the execution of an LOI could trigger franchise disclosure obligations, and in some cases create additional issues for the franchisor (e.g., currency restrictions or tax implications). A franchisor should determine whether it will require from a prospective franchisee a deposit or periodic payment to offset its expenses in exploring an international franchise opportunity and whether those payments would be refundable. In Alberta, Canada, under the Alberta Franchises Act, a prospective franchisee is entitled to a disclosure document 14 days before it "signs any agreement relating to the franchise, or [makes] payment of any consideration relating to the franchise, whichever is earlier." While such language is quite broad, the amount and type of consideration paid by the prospective franchisee could actually exempt the franchisor from the disclosure requirement. In Section 4 of the Act, preliminary agreements that contains terms of a fully refundable deposit - a deposit that does not exceed 20% of the initial franchise fee, is refundable without any deductions and which does not bind the prospective franchisee to enter into any franchise agreement, are exempt from disclosure obligations in Alberta. In contrast, the Ontario, Canada franchise statute (the Arthur Wishart Act (Franchise Disclosure), 2000) also requires disclosure to a prospective franchisee at least 14 days before it signs any agreement relating to the franchise or makes payment of any consideration relating to the franchise, but unlike Alberta, there is no exception of any kind made for a deposit. So uniformity within a country cannot be assumed. In Mexico, Mexican legislation makes a distinction between payments and deposits associated with preliminary agreements. Payments that "cover any costs and expenses into which franchisor will incur for the analysis and/or investigation of the franchisee's profile" are considered consideration and therefore subject to the payment of income tax withholdings.[9] However, in principle, deposit payments are not subject to withholding tax obligations. A franchisor that requires any payment related to an LOI is best off consulting local counsel about franchise law applicability to those payments. A franchisor

[7] N.Y. Comp. Codes R. & Regs. tit. 13, § 200.11.
[8] Steven Goldman, Gaylen Knack, Jorge Mondragon, and Andrew Loewinger *Using Letters of Intent, Term Sheets and Other Interim Deal Documents in International Franchising* in International Franchising in IBA/IFA 26th Annual Joint Conference, May 18-19, 2010 at 6.
[9] *Id*. at 13.

may also find it beneficial to negotiate and include provisions in its LOI that requires payments be made in the currency of its home country and that prospective franchisee be responsible for any applicable taxes.

(iii) Multi-Jurisdictional Franchise Transactions and Unclear Franchise Laws

Sometimes parties will sign an LOI for a multi-jurisdictional territory. The question then is, if one of the countries has an applicable franchise law, does the LOI trigger the applicability of that law? The answer is: it depends. Unfortunately the applicability of franchise laws in many jurisdictions is unclear, so neighboring attorneys may be unable or reluctant to give a firm answer on whether such laws apply to a letter of intent, given the ambiguity.[10] Depending on the jurisdiction, a franchisor may be well-advised to register trademarks included in its LOI; commence registration immediately if the country has a notorious reputation for trademark infringement or a lengthy registration period; or register with a local franchise authority before soliciting a franchisee in that country. Essentially, a franchisor interested in a franchise business that spans multiple countries should research the franchise laws of each independent country or hire local counsel in each country to ensure franchise compliance.

6. Consequences of Triggering Disclosure Laws

A franchisor's failure to comply with franchise sales laws of foreign countries may have serious consequences. Foreign franchise laws could require, or provide franchisees the right to demand, rescission of franchise agreements, reformation, payment or refunds or damages, civil and criminal penalties, or a combination of these remedies. Although a franchisee may have no interest in demanding rescission, a franchisor's failure to abide by applicable franchise law does give the franchisee leverage in the negotiation of a new franchise agreement.

A franchisor must be aware of the scope of time a franchisee has to rescind an executed franchise agreement if it fails to properly disclose a franchisee before entering pre-contractual negotiations or agreements. For example, mandatory pre-contractual disclosures and the rights of rescission have become staple provisions in Canadian franchise laws.[11] As noted above, it is generally accepted that payment of any monies or an LOI, with any binding provisions, would trigger the disclosure requirements under the Ontario franchise sales law. When a franchisee in Ontario, Canada, does not receive disclosure documents at all, when disclosure was required, that franchisee is entitled to a 2 year period during which it can exercise its right to rescind its franchise agreement.[12] This arguably leaves the franchisor vulnerable to a dissatisfied franchisee rescinding its otherwise fair franchise agreement simply because the franchisee wants out, and having very little to do with the actual lack of disclosure. The administrative costs and the investment time is lost by the franchisor and in some cases, the franchisee, who may not have been operating the franchised business profitably, could make profit from such rescission and reimbursement and damages that a franchisor may have to pay. For Ontario, Canada franchisees that did receive disclosure, but imperfect disclosure, such franchisees would be entitled to 60-day right to rescission, which too can be a headache for a franchisor.

Depending on the scope of a franchisor's violation, a franchisor could also be banned from conducting business in certain jurisdictions. Government agencies could elect to go after a franchisor for civil and criminal penalties. In lieu of all the consequences of non-disclosure, it is imperative that before a franchisor negotiates any preliminary agreements or pursues any

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[10] Kerry Olson, Frank Robinson, and Kendal Tyre, *From LOI to Closing: Getting an International Franchise Deal Done* in International Franchising in ABA 37th Annual Forum on Franchising, October 15-17, 2014 at 7.
[11] George J. Eydt and Edward Levitt, *The Devil is in the Details: How Canadian and U.S. Franchise Legislation Differs*, Franchise Law Journal, Volume 32, Number 4, Spring 2013.
[12] Ontario *Arthur Wishart Act* §6 (2).

franchise sales in a jurisdiction, it know, understand, and abide by any and all franchise sales law requirements.

7. Duration and Termination of an Interim Deal

Assuming that a franchisor has complied with all applicable franchise laws in entering into pre-contractual negotiations or agreements, the franchisor's next objective should be to get the deal through to its final stage, signing the franchise agreement. International franchise transactions can be multifaceted and extremely costly and lengthy processes. In countries where registration periods are long, an executed LOI, depending on its terms, may indicate to a franchisor that it is dealing with a serious prospective franchisee that is "in it for the long haul." An LOI should be the precursor that establishes the foundation of the franchise relationship and agreement, not another financial and administrative burden for the parties. As a result, a franchisor should not expect its LOI to have an extensive term. Like applicable franchise laws in different countries, the duration of an LOI will always vary; however, typical duration can range anywhere from 60 to 180 days. An LOI has the potential to expire if the parties do not enter into a binding franchise agreement by its end. The franchisor and franchisee may decide in that case that they would like to extend their LOI, or ultimately agree to part ways. If expiration of the LOI occurs, there may be continuing obligations of both parties. The franchisor may be expected to refund any payments and/or deposits made by the prospective franchisee and the franchisee may be required to keep terms of the LOI confidential and not use the franchisor's trademarks. Such post-expiration are not uncommon.

As discussed earlier, franchisors or franchisees may face legal consequences if an LOI agreement is deemed binding, but is terminated. Cases like *Texaco, Inc. v. Pennzoil Co.* in the United States are a great example of this.[13] The Texas court found that the preliminary agreement between two parties contained essential elements of a contract thus demonstrating the parties' intent to be bound and resulting in one of the parties being awarded damages. Franchisors must understand that there can be costly consequences to terminating a preliminary agreement, especially if the agreement is not well drafted or ambiguous on the agreement's binding or non-binding nature. Franchisors entering into international franchise transactions should be well aware of the franchising laws, if any, that would apply to post-termination mechanics of a preliminary agreement (e.g., reimbursement requirements, confidentiality agreements, potential liability, etc.).

While there is no "one-size-fits-all" approach to starting an international franchise transaction, it is essential that a franchisor know, or hire someone who knows, the legal implications of its international franchise activities and to ensure that preliminary agreements are written thoughtfully and carefully, as to protect the franchisor from unnecessary drawbacks. Being well-informed and well-prepared to enter into an international franchise transaction is one step closer to a successful international expansion.

8. Duty of good faith: how is this going to affect the interim deal document in a civil law country?

The principle of good faith is an established principle of Civil Law going back to the Roman Codex Justinianus that dominated the development of contract law in Europe. All Civil Law Countries recognize the concept that contracts must be performed in good faith and many common law countries such as for example the UK have started to embrace the concept in recent years. However, the meaning of "good faith" can differ greatly from country to country. In Germany the concept of good faith is extremely sophisticated and far reaching whilst in the

[13] 729 S.W.2d 768 (Tex. App 1987).

UK it remains rudimentary. Article 242 of the German Civil Code provides: " The parties must perform their obligations in accordance with the requirements of good faith and trade custom" [14]. This provision is understood to express a general principle of universal application. It covers many principles that exist equally in common law such as the prohibition on benefitting from one's own wrong. The principle of good faith is supplemented by the fact that Civil Law countries recognize the existence of pre-contractual obligations arising from the duty of good faith, the so-called "culpa in contrahendo" principle. Article 311 (2) Rule 1 of the German Civil Code expresses the principle as follows; " An obligation arises upon the commencement of contractual negotiations… ". Clearly at the stage when the parties are contemplating a term sheet, contractual negotiations are well under way, so Civil Law obligations exist.

What are these obligations ?

The parties are required to act honestly and in good faith during the pre-contractual phase. This can give rise to the following obligations:

- To act in such a manner that the property and health of the other party are not damaged
- Not to abandon negotiations without good reason

Damage to health can occur when negotiations are conducted in an unsafe environment. For example a shopper in a supermarket slips on a banana skin before he has made a purchase. Damage to property can occur where one party has suffered a loss as a result of the unexpected or sudden termination of negotiations by the other party after a term sheet has been signed. In order to make a successful claim for loss and damage in connection with abandoned negotiations, the claimant needs to show (1) that he was led to believe that the contract would be signed and (2) that negotiations were abandoned without good reason. The damages payable are typically limited to wasted effort (eg legal fees, travel costs). In some rare cases loss of profit claims can be made for example where another equal or better opportunity has been lost. For example an area developer franchisee may have been looking at two alternative franchise concepts for a new country. They may have chosen to focus on the first concept telling the other franchisor that they are unable to develop two brands in parallel. If the first concept abandons negotiations unreasonably and the second concept has at that point appointed another developer, the franchisee may attempt a loss of opportunity claim.

This is not an easy claim to make as the claimant needs to demonstrate that the other side made clear representations to the effect that the contract would definitely be approved. This could be the case where an express promise has been made ("Don't worry it will just be a formality to get this signed…") or where the franchisee has been encouraged to start operations. One obvious area of risk for franchisors arises in connection with situations where the franchisee is permitted to start setting up the franchised business whilst contractual formalities are pending. For example disclosure and registration in foreign countries may be outstanding and in the meantime the franchisee is encouraged in the meantime to sign a lease for the first unit or to attend training.

Obviously a well-drafted term sheet would make it clear that it is non-binding. However, that may not be enough to defeat a claim for breach of pre-contractual duty given that the duty arises automatically if negotiations have been commenced. The term sheet may also state that it expires if no contract has been agreed by a certain date. That may help with justifying a refusal to continue negotiations beyond that date. A situation, however, where the term sheet contains detailed contractual terms and the franchisor or franchisee later attempts to renegotiate a better deal could give rise to a claim. Cases have been reported where a claim has

[14] Schoenfelder, Deutsche Gesetze BGB.

been entertained by the courts in connection with unreasonable new demands derailing negotiations. [15].

9. Non compete clauses : Are they common? Competition restrictions in the EU

Many letters of intent contain confidentiality obligations. These should of course be placed in the legally binding section of the document. Sometimes restrictions on competition are encountered at the pre-contractual stage but this is less common.

The following restrictions are possible:

- **Negotiation exclusivity**: franchisor and franchisee agree not to enter into negotiations in respect of a competing system and territory during the lock out period, typically the negotiation period under the LOI.
- **Lock-out Period:** Some franchisors require the prospective franchisee to commit to a cooling off period if negotiations fail. During that period, the franchisee is not permitted to open a competing business. Lock-out periods of 6-12 months are proposed by some franchisors.
- **Reverse Lock-out**. Sometimes the franchisee will insist that the franchisor may not enter the proposed territory in partnership with a competitor of the franchisee or at all during a certain period of time after negotiations have been abandoned. This can be the case where the franchise is a conversion franchise and the franchisee has an existing business that it needs to protect.

From a business perspective it is easy to see why the parties may want to impose these restrictions. However, as lawyers we need to ask ourselves if these restrictions are enforceable.

Are these non-compete obligations enforceable?

Enforceability of restrictive covenants in Europe is governed by two legal regimes. Firstly, the restriction must be valid under applicable law. Second, the restriction must be permitted under European competition law.

Most European legal systems permit a restrictive covenant if it is necessary to protect the reasonable interests of the relevant party. In the context of a pre-contractual negotiation, it is difficult to see what legitimate interests are being protected. Typically, no training is given until the final agreements have been signed and the confidential information that is being shared during the LOI stage is usually limited to financial information and market data. It is likely to be possible to justify ‘negotiation exclusivity” but not a market lock-out unless special circumstances exist.

Equally under EU Competition rules it may be difficult to justify a restrictive covenant that extend beyond the exclusive negotiation period. The EU Vertical Restraints Block Exemption Regulation that applies to franchise agreements deals with post-termination restrictions in Article 5. Article 5 b) only permits restrictions that extend beyond the termination of an agreement provided that the following requirements are met:

- The restriction is in respect of good or services that compete with the contract good and services and
- The restriction is limited to the premises where the franchisee has operated the business

[15] For example asking for an excessively onerous payment guarantee, German Federal Court decision 1980 NJW 80, 1683.

- The restriction is essential to protect the know-how of the franchisor that has been transferred to the franchisee

It is highly unlikely that these conditions would be met in a pre-contractual negotiation. Accordingly, it would appear that a post-termination restriction in a term sheet is not enforceable.

10. Breaking (or changing) the terms of an interim deal document: (i) a confidentiality obligation is effectively enforceable (and enforced) or it is rather a "moral suasion" type of clause? (ii) non-binding commercial terms are actually set in stone?

A confidentiality obligation should be placed in the binding part of the term sheet. Correctly drafted there is no reason why it would not be enforceable provided that it is expressly stated to be legally binding and protects genuine trade secrets. In line with standard drafting practice, information that is already in the public domain cannot be protected.

Regarding the non-binding commercial terms that are set out in an interim deal document, the legal position in common law countries is clear. These conditions are not binding. It is therefore possible to renegotiate and the suasion is moral rather than legal. Obviously a party that acquires a reputation for renegotiating provisions that were the subject of prior negotiation and agreement (as documented in a term sheet), may find it difficult to find much interest from potential franchisors or franchisees as the case may be once this behavior becomes known. There is a cultural aspect to this as some cultures have a strict code of honor around hand-shake deals whilst it is considered acceptable in other communities to request further concessions and discounts at the contract stage.

If the language in the term sheet is not clear or does not contain a complete list of all relevant matters, this may be used to re-open negotiations. One practice that may work for franchisors to prevent this from occurring, would be to state in the term sheet that "*any terms not expressly dealt with in this term sheet will be as set out in the standard form of franchise agreement of the franchisor*". Before negotiating international contracts, franchisors should prepare an international form of franchise agreement and matching standard term sheet, to minimize areas of unclarity and negotiation. Most franchise term sheets offer flexibility on financial and commercial terms, but not on the technical legal provisions.

In civil law countries, as referred to above, it is possible that a claim can be made for breach of pre-contractual duty, if a party deviates from the commercial terms set out in a signed term sheet without good reason.

Biographies

Andria B. Hill

Andria Hill is a counsel at Hilton, where she is the lead attorney responsible for managed and franchised hotel development in South America. Ms. Hill also has extensive experience in hotel development in Mexico, Central America and the Caribbean. She negotiates hotel management agreements, franchise agreements, financing agreements and other related development agreements with hotel developers and owners. She advises the company's development team in navigating the unique legal and business landscapes of developing hotels in countries across the region and advises the company's owner relations team in managing issues arising during the long-term management and franchise relationships with hotel owners. Prior to joining Hilton in 2012, she practiced real estate law with Arnold & Porter LLP, with a particular focus in the hospitality industry, and real estate and corporate law with Covington & Burling LLP. Ms. Hill received her J.D. from Harvard Law School in 2005 and her A.B. from Princeton University in 2002.

Andrew P. Loewinger

Andrew Loewinger is a partner in the Washington, D.C. office of Nixon Peabody LLP (an international law firm of 700 attorneys with offices throughout the United States, and in London, and Shanghai). He has represented numerous U.S. and non-U.S. companies in franchising and distribution matters in the United States and internationally on international franchising, licensing and distribution matters. Andrew is the immediate past Chair of the International Franchising Committee of the International Bar Association and a former member of the Governing Committee of the American Bar Association's Forum on Franchising. Andrew is the co-editor and co-author of International Franchise Sales Laws published by the American Bar Association in 2006. He was appointed in 2004 as the first Director of the International Franchise and Distribution Division of the ABA's Forum on Franchising. He has been recognized for many years as one of the top franchise lawyers in the United States and internationally in Who's Who Legal, The International Who's Who of Business Franchise Lawyers; Chambers USA: America's Leading Lawyers for Business; and Best Lawyers in America (in franchise law). Andrew has a B.A. from The Colorado College (Phi Beta Kappa, magna cum laude), a Masters in International Affairs from Columbia University; and a J.D. from Georgetown University Law Center.

Babette Märzheuser-Wood

Babette heads up the firms Retail Group. She is rated by Chambers Global as a top 10 global franchise lawyer. She is a partner in the firms' Franchise Group and heads up the European Franchise team at Dentons. She specializes in international franchise and concession agreements and IP-driven joint ventures. Babette has transactional experience in all 28 EU Member States. She also advises clients on franchise agreements and other innovative structures for international expansion in the global marketplace. Babette has particular expertise in the hotel, leisure, retail and restaurant sectors. She is dual qualified in Germany and the UK. She is recognised as one of Europe's leading experts in retail, hotel and leisure franchising with a particular emphasis on German speaking Europe. Babette is recognised as a leading expert in international franchising by Chambers Global which says she is "highly regarded for her experience in the hotel and leisure industry". She is also recommended by The International Who's Who of Franchise Lawyers, Chambers UK and Legal 500 for her franchise expertise. She is listed as a recommended country expert for Germany in Chambers Global. Babette's research on the role of franchising in the European hospitality industry has attracted widespread media attention. Babette is the author of "International Protection of a Franchisor's System", Vancouver 2004. She has written the European section of Butterworth's Franchise Laws. She lectures regularly around the world on franchise law and was part of a team of lawyers that advised the Russian Government on the use of franchising to kick-start small businesses. She is an associated editor of the Franchise Law Review. Babette is a member of the ABA Forum on Franchising, the IBA Franchise Committee and the IFA. She is dual qualified in both Germany and the UK. She speaks English, German, French, Spanish and Russian.

Francesca R. Turitto

Francesca Turitto is an of counsel to the law firm Roma Legal Partners. She specializes in international franchising and distribution, representing foreign companies wishing to enter the Italian market and Italian companies expanding their network abroad. She also has an extensive experience in corporate and financial transactions, national and international, including mergers and acquisitions, joint ventures, privatizations and private equity deals. Before joining Roma Legal Partners, Francesca was a senior counsel at the Italian office of Allen & Overy for more than ten years. She coauthored several articles for the International Journal of Franchising Law and wrote articles on various aspects of financing and corporate matters published by Butterworths Journal of International Banking and Financial Law and contributed to the book on “International Acquisition Finance” published by the Oxford University Press. She is the co-author of the Italy chapter of the 2014 edition of the book “International Franchise Sales Laws”, an American Bar Association Forum on Franchising publication. She is a lecturer on international franchising at the Master in business law, jointly offered by the LUISS university in Rome and the Italian association of corporate counsel (AIGI). Francesca is the vice-chair of the International Bar Association International Franchising Committee and is often called to speak at international events. She has been constantly recognized in the last years by the International Who's Who of Franchise Lawyers as one of the world's leading practitioners in the field of franchise.