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SHOULD INTERNATIONAL DISCLOSURE (DOCUMENTS) BE THE NORM OR "BEST PRACTICE" FOR INTERNATIONAL FRANCHISE TRANSACTIONS?

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1. Introduction

Most every franchise attorney based in the United States cut their teeth on the preparation of Federal Trade Commission (FTC) mandated Franchise Disclosure Documents (and those that have at least one gray hair cut their teeth on the FTC's prior form of Uniform Franchise Offering Circular). In addition, many foreign franchise attorneys have either always or for some time been under a government regulated franchise disclosure obligation in their country, and therefore had the "benefit" of being able to focus on a specific mandatory disclosure obligation and, in most cases, a specific mandatory format for disclosure. In these instances, there is a law, regulations, guidelines and other directions that provide the disclosure topics or questions and the franchisor can focus on gathering the specific information, distilling it and making sure it goes in the right place. While it is not always plug-and-play, normally there is a fairly clear path to compliance in these countries.

To those who draft international disclosure documents today it may seem like every country has a franchise disclosure law, but in reality less than 30 countries have laws governing the sale of a franchise and requiring franchise disclosure or registration, and many of these laws remain relatively new and untested or are seemingly a moving target with amendments or additions almost on a yearly basis.[1] And, since there is no generally applicable international disclosure obligation that applies globally, the great majority of countries in the world have no statutory, franchise-specific express disclosure obligation. To some, that connotes a freer, Wild-West notion of international franchising where deals are completed between business persons without the "interference" of lawyers.

Of course, that Wild West thinking can lead to the involvement of and need for lawyers since each country's laws present different issues and potential pitfalls when it comes to pre-sale activities. While many franchisors will refrain from providing any type of formal pre-sale disclosure document or legal-compliance document when not required to do so, others have long since thought it a best practice to provide all franchise prospects with some form of disclosure or information for reasons ranging from the information being readily available, to the information being requested, to the information being provided to hopefully avoid a lot of questions from the franchise prospect during the pre-sale process. Whatever the motivation, it is safe to say that there is not really any real meeting of the minds among franchisors or

[1] As of the date this Chapter was prepared, these countries include the following: Argentina, Australia (Australia Franchising Code, Bus. Franchise Guide (CCH) ¶ 7001), Belgium (Belgium Franchise Law, unofficial translation, Bus. Franchise Guide (CCH) ¶7008), Brazil (Brazil Franchising Law, Bus. Franchise Guide (CCH) ¶7015), Canada (specifically the provinces of Alberta (Alberta Franchises Act, Bus. Franchise Guide (CCH) ¶ 7010; Alberta Regulation, Bus. Franchise Guide (CCH) ¶7015), British Columbia, Manitoba, New Brunswick (Franchises Act, Bus. Franchise Guide (CCH) ¶7045), Ontario (Ontario Franchises Act, Bus. Franchise Guide (CCH) ¶7050), and Prince Edward Island (Franchises Act, Bus. Franchise Guide (CCH) ¶ 7058)) China (See Generally, Bus. Franchise Guide (CCH) ¶7060, et seq.), France (Loi Doubin and Decree of Implementing Regulations, Bus. Franchise Guide (CCH) ¶¶7130, 7135, 7136), Indonesia (Government Regulation No. 16, Bus. Franchise Guide (CCH) ¶7145), Italy (Rules on the Regulation of Franchising, Bus. Franchise Guide (CCH) ¶¶7150, 7152), Japan (Medium-Small Retail Business Promotion Law, Act No. 101 of 29 Sept. 1973, as amended in April 2002, Bus. Franchise Guide (CCH) ¶7158), Kazakhstan (Bus. Franchise Guide (CCH) ¶7160), Malaysia (Franchise Act of 1998 *Act No. 950) Bus. Franchise Guide (CCH) ¶7180), Mexico (Franchise Provisions, Law on Industrial Property of June 27, 1991, Bus. Franchise Guide (CCH) ¶7210; Regulations Under the Law on Industrial Property of Nov. 23, 1994, Bus. Franchise Guide (CCH) ¶7215), Romania (Ordinance and Law, Bus. Franchise Guide (CCH) ¶7372), Russia (Bus. Franchise Guide (CCH) ¶7230), South Africa (Bus. Franchise Guide (CCH) ¶7244), South Korea (Act on Fairness in Franchise Transactions, Bus. Franchise Guide (CCH) ¶¶7170-7174), Spain (Article 62, Bus. Franchise Guide (CCH) ¶7250, at 10,051), Sweden (Bus. Franchise Guide (CCH) ¶7257), Taiwan (Standards Governing Disclosure of Information by Franchisors, Bus. Franchise Guide (CCH) ¶¶7260, 7262), Tunisia and Vietnam.

their attorneys as to whether some type of formal pre-sale disclosure should be provided to franchisee prospects in international jurisdictions that do not have franchise-specific disclosure laws, much less what type of information should be provided and in in what type of format if the decision is made to in fact provide some type of formal disclosure.

This paper discusses the underlying pre-sale franchise disclosure and risk-related issues that franchisors have to consider when franchising into a country that does not have an express statutory, franchise-specific disclosure obligation.

In all cases, the authors strongly recommend that franchisors should seek advice from experienced counsel in the country(ies) at issue.

2. Disclosure Obligations When There is no Specific Franchise Disclosure Law

There are multiple treatises, books, articles and other materials related to those countries that have instituted franchise disclosure laws. Truth be told, the authors of this paper and most franchise attorneys who practice in the United States and international jurisdictions with franchise disclosure laws spend an inordinate amount of their time complying with, or finding exclusions or exemptions for, these laws. In these instances, attention is more focused on whether an exemption exists, whether discussions or a letter of intent triggers a disclosure obligation, whether a franchise registration requirement must be satisfied before a disclosure document is prepared or provided, or even whether there are other pre-conditions to franchising in the country that are potential road blocks for the franchisor (from concepts such as the 2/1 requirement in China, to local franchisee ownership requirements to foreign exchange, intellectual property, competition law or other obstacles or limitations).

As a result, franchisors that are franchising into a country that does not have a statutory, franchise-specific express disclosure obligation all too often consider themselves entirely freed up from the types of legal constraints that apply in the US and other countries that have pre-sale disclosure or registration requirements. Most outside counsel franchise attorneys who practice in the international area are used to a call or email from a client that begins with something like "We received an inquiry from a prospect in Mongolia. Anything I need to worry about? Disclosure? Registration? Or can I sign the LOI I sent them last week because they are here in our offices right now and are ready to move forward?". This is in some ways code for "do I really need your help on this one?".

As attorneys, we need to be careful that while we may be tempted to consult the latest, greatest franchise law treatise or paper outlining all the international franchise disclosure laws, and then quickly respond with something akin to "No disclosure. No registration. Good to go", there can be traps for the wary out there in terms of pre-sale negotiations and sharing of information just as there are in the United States, even where there may be an available exclusion or exemption from disclosure obligations under the US and state franchise laws.

To that end, franchisors in the United States are generally familiar with the common law legal concepts and related causes of action that all good franchise plaintiff's attorneys will almost certainly raise when there is a franchise dispute:

- Breach of a Duty of Good Faith and Fair Dealing
- Fraud
- Fraudulent Inducement
- Misrepresentation

- Deceptive Trade Practices
- Contact of Adhesion
- Breach of Fiduciary Duty

Litigators know that these theories are all tailor made for franchisees to raise claims that certain duties and obligations were owed to them not only during the long franchise relationship, but also BEFORE that franchise relationship began, even when there was a franchise disclosure law in place and disclosure information was provided to the franchisee in the correct format and even at the correct times.

Internationally, many of these same general theories exist in some form or manner. Without attempting to cover the entire world, this section of the paper explores one of these theories generally and then looks at two selected jurisdictions in the context of international franchise sales.

2.1 *Culpa in contrahendo*

The concept of *culpa in contrahendo* (roughly translated from Latin as "fault in conclusion of a contract") is akin to an inherent, extra-contractual obligation of good faith with respect to the negotiation and execution of contracts.

The concept is by no means new or novel,[2] but many US franchisors may not be aware of it. Still, it is a living and viable concept under many civil law jurisdictions.[3] Generally speaking, the concept recognizes that franchisees are businesspersons who have a general obligation to seek and obtain information on their own initiative regarding the four corners of the proposed agreement as well as market and other circumstances outside the four corners, and the potential impact of those circumstances on their business. That said, the concept of *culpa in contrahendo* effectively creates an exception to the general rule and applies where there are particular circumstances of which only the franchisor is aware and which are readily identified to be of importance to the prospective franchisee's business making process with respect to the entry into the franchise agreement.

In practice, the concept of *culpa in contrahendo* leads to the rather straightforward idea that the franchisor must refrain from providing misleading information regarding itself and the franchise offering, and correspondingly disclose to the prospective franchisee all relevant information about the franchisor and the franchise offering. This is of course very broad and very subjective in nature.

In practice, one might think about the concept of *culpa in contrahendo* in the terms of a material change under historical US franchise law. In that sense, while still inherently subjective, the analysis is generally whether a reasonable franchisee would consider the information material for purposes of making a reasonable business decision to purchase franchise. Interestingly, in Canadian provinces with franchise laws, the franchise laws add a material *adverse* nature trigger to the material change consideration, and it would seem to make sense that an event that has an adverse effect would be relevant and necessary to the concept of *culpa in contrahendo*, but since reasonable minds may differ it would also seem that some events that they franchisor might deem positive or neutral could be deemed negative by the prospective franchisee, especially in hindsight.

For US franchisors that are used to a detailed set of disclosure guidelines, the vague nature of the concept of *culpa in contrahendo* can be daunting, but again in some ways the material change concept can

[2] See Kessler, Friedrich and Fine, Edith, "*Culpa in contrahendo*, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study (1964). 77 Harvard Law Review 3, 1964.
[3] Argentina, Germany and Switzerland are countries that follow some form of *culpa in contrahendo*.

be helpful even if there was no specific original disclosure that has changed and must be re-disclosed with the updated information.

For instance, whether or not any documentation or information has been provided orally or in writing to a prospect in prior correspondences, there are a number of events that could all be considered relevant information in the context of *culpa in contrahendo* that should be disclosed to a prospective franchisee during the negotiation of the franchise agreement if the franchisor has the information and the prospective franchisee does not, and is unlikely to be able to obtain it without extraordinary effort, including events such as:

- *A pending or concluded merger and acquisition transaction*

  This is perhaps the most obvious type of timely, relevant issue that should be disclosed to a prospect if/when known no matter the existence or non-existence of a franchise-specific disclosure law, especially if control and/or management of the franchisor is likely to change.

- *A change in key franchisor personnel*

  The departure of a key franchisor executive or person involved with the franchise program can be a material issue and of primary concern to an international prospect, especially if the prospect may have made only one trip to the US and the person was the main connection to the franchisor.

- *A material change in the makeup of the system (i.e., loss of a large franchisee, or number of franchisees)*

  The departure (or imminent departure) from the franchise system of a large franchisee in a neighboring country could be relevant to a prospective franchisee, particularly if the departure and event surrounding it could have a negative effect on the new franchisee's business.

- *A large litigation matter*

  While a typical franchisee litigation matter in the US that is brought against an affiliate franchisor may not be particularly relevant, an arbitration or litigation matter involving an international franchisee in the same region as the prospect may be relevant, especially if the franchisor has not shared contact information on other franchisees such that the prospective franchisee may have limited means of learning of the arbitration or litigation on its own.

- *Lack of trademark rights, or a negative trademark decision or infringement issue*

  This can be one of the most relevant issues for an international transaction, especially in hindsight. Smaller franchisors are in many cases likely to refrain from seeking trademark protection until they think a deal is close, and may not know of issues until after a transaction has occurred.

- *Changes in the supply chain, such as material shortages of, or cost increases for, a key product or service material to the franchise*

  Franchisors who may have a finely tuned US supply chain with multiple safeguards may have fewer safeguards or available options internationally, and to the extent there is a

material change in the supply chain or availability of proprietary products this would certain be relevant information to a prospective franchisee.

- *Changes in key laws or regulations materially affecting the business*

  Changes in key laws and regulations are most certainly material to prospective franchisees, but in many instances the franchisor may not have readily available or current information in international jurisdictions unless or until it has engaged counsel or other advisors in the country that have the wherewithal and contacts to identify and alert the franchisor of key changes.

On the surface, it would seem to be common sense that these types of material events should be disclosed and, if intentionally withheld, could be the very essence of "laying behind the log" with respect to the concept of *culpa in contrahendo*. But, of course not everyone in the franchising world will have the wherewithal to think about the event and link it to the pending transaction, and still others might link the two and take the darker path to consummate the transaction without disclosure of the event for monetary or other gains. Either way, this is of course how these types of pre-sale disclosure cases come about, and those with the worst facts tend to make the most noise and do the most damage to both the franchisee (on the front end) and the franchisor (on the back end).

We are all aware of instances where timing, circumstances, speed of transactions, language barriers and other circumstances result in acts, errors or omissions that harm the franchisee, and later on serve as the basis for claims. Where there is no specific breach of a franchise disclosure law, the natural fall back argument is a breach of good faith and fair dealing, fraud, misrepresentation and/or deceptive trade practices, or depending on the jurisdiction, *culpa in contrahendo* liability.

None of these are easy claims to win and are many times heavily fact-oriented, but similar to the US where a winning claim related to good faith and fair dealing, fraud, misrepresentation and deceptive trade practices can bring damages and even potentially rescission, a typical winning remedy for a claim involving *culpa in contrahendo* is generally rescission (i.e., a right be to be placed in the position the franchisee would have been in had the franchise agreement never been executed). In addition, attorney's fees, expenses and potentially even disgorgement of initial fees and royalties could be possible in the worst situation. And while many franchisors use arbitration internationally, there is always the chance of winding up in a local court where there is a bias for the local party and the facts associated with a *culpa in contrahendo* case provides the local judge all they need to find for the franchisees.

Thus, franchisors are best served by understanding that the remaining parts of the world that might seem like the Wild West are not really so wild, and that common sense, decency and fairness cannot be set aside in franchise transactions in countries that do not have express, pre-sale franchise disclosure laws.

2.2 Germany

Several years ago, many US franchisors got wind of a case in Germany that seemed to infer that there was a general disclosure obligation in Germany. This was a shock to many since there is no franchise-specific disclosure law in Germany, but to German practitioners it was nothing new.

When drilling down, the German approach to pre-contractual disclosure requirements comes back around to familiar concepts to US franchisors, namely where you intentionally or negligently mislead a

party or withhold important information from them, then they will likely have a cause of action for fraud, misrepresentation, breach of good faith[4] and fair dealing and/or breach of contract.[5]

This has been proven out with a series of German court decisions. First, there was a decision of the Higher Regional Court of Munich in 1993[6] that stated that: (

> "The franchisor is confronted with two main types of obligations during contract negotiations: First, the franchisor is not allowed to deceive or mislead the (potential) franchisee as to the essential contractual circumstances. Second, the franchisor is obligated to disclose to the (potential) franchisee such circumstances which are known only to the franchisor and of which the franchisor knows or must know that the other party's decision is influenced by their knowledge. The disclosure obligation particularly affects the circumstances relevant for the franchisee's commercial success, which the franchisor is more familiar with due to the franchisor's knowledge of the system and the way it works on the market. The scope of the disclosure obligation depends on the circumstances of the individual case, taking into account the principle of good faith. Thus, it is not possible to establish general binding guidelines about what precisely the franchisor must disclose to the franchisee and which exact documents the franchisor has to provide before the conclusion of the contract."[7]

A later excerpt from a judgment of the Higher Regional Court of Schleswig-Holstein in 2008 stated that: (1) the franchisor must inform the franchisee correctly and completely about the profitability of the system; and (2) the franchisor, which is liable to pay compensation due to the pre-contractual clarification obligation, cannot make use of the franchisee's contributory negligence if the franchisee believes the franchisor's promotional statements.

This is of course the type of vague judicial pronouncement that gives US franchisors heartburn. It is one thing to be provided a list of guidelines or questions to answer for a statutory mandated disclosure, it is quite another to try to figure out what or how to gauge the franchisee's commercial success. How and when does a franchisor try to make these determinations? What if the franchisor does not have a reasonable basis to assess profitability or success in Germany? Is a franchisor better off not providing anything if they are unsure of the relevance of the performance elsewhere, or are they better off providing something that is heavily disclaimed and arguably misleading or irrelevant? Reasonable minds can and do differ on this subject, and US franchisors will definitely take different positions when confronted with this type of obligations.

Importantly, while again US franchisors that think about sales or profitability information automatically think of Item 19 of the US FDD, supplemental earnings claims, reasonable basis requirements and other US guidance, German case law does not look to a specific format or form for the disclosures; instead the goal is that the information is provided so that the franchisee can make an informed decision. This is an inherently different thought process than in the US and other jurisdictions where sometimes the form of the disclosure takes precedent over the actual substance of the disclosure because there is so much reliance on, and resistance to deviate from, the disclosure guidelines that have been promulgated and drummed into the heads of US franchise lawyers.

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[4] German Civil Code Section 242.

[5] See Sec. 331 ss. 2, 241 ss. 2 German Civil Code; "Getting the Deal Through", Germany 2015.

[6] OLG München, NJW 1994, 667 f; see also OLG Hamm, Judgment of 22 December 2011, file No. 19 U 35/10.

[7] Higher Regional Court of Munich 2013.

2.3 UK

As the birthplace of common law and in precursor to the US legal system, US franchisors that are inexperienced with international franchising might be surprised that the UK does not have a franchise-specific disclosure law. Of course, that does not mean franchisors have no disclosure type obligations. As US franchisors would likely expect, there are under English common law principles various types of fraud and misrepresentation based actions, including fraudulent misrepresentation, negligent misrepresentation and innocent misrepresentation. In all kinds of misrepresentation, whether "fraudulent", "innocent" or "negligent", the other party may rescind from the contract.

The UK has also enacted multiple consumer based laws that can be applied to the pre-sale contracting phase of franchise transactions, including the The Fair Trading Act 1973, the Trading Schemes Act 1996, The Unfair Contract Terms Act 1977 and the EC Directive on Unfair Contract Terms in Consumer Contracts – implemented by the Unfair Terms in Consumer Contracts Regulations 1994. For US franchisors entering into the UK, we may be used to adding waivers, disclaimers and non-consumer language to franchise agreements to address these laws, but in practice these laws are again akin to good faith and fair dealing, fraud, misrepresentation, deceptive trade practices and *culpa in contrahendo* concepts and provide similar potential avenues of relief and remedies for material failures related to disclosures made (or withheld) at the franchise agreement contracting and negotiating phase.

3. Formats for International Disclosure

There are numerous ways to provide disclosure to franchise prospects in jurisdictions where no formal, pre-sale franchise disclosure obligation exists. These range from providing a US FDD to complying with a non-binding disclosure obligation from a local franchise association to providing a wrap disclosure document to providing a truncated "international information memorandum" with general information about the franchisor, offering and agreements. In all cases, care must be taken to avoid confusing prospects with information that is not relevant to the offering at hand, or worse providing misleading information that wrong or completely or partially inapplicable in the local jurisdiction. Otherwise, seemingly good faith attempts to provide information could lead to greater harm and potential violation of the various pre-contractual duties discussed in this paper.

Perhaps even more important when providing some type of franchise-specific disclosure is deciding what not to include. Arguably, the laundry list of items in a US FDD are all materials to a US prospect, but does that mean that all those items are relevant to an international prospect? Do US disclosure concepts such as Item 10 financing or Item 18 Public Figures provide any real benefit to an international franchisee prospect?

3.1 Providing a US Disclosure Document

Most US franchisors considering an international franchise transaction will have a current (or fairly recent) US franchise disclosure document that provides very specific and important information about the franchisor and the US offering. In such a situation, especially with a relatively new franchisor, the franchisor may be tempted to provide that US franchise disclosure document to an international prospect, perhaps with a cover letter stating that the franchisee should disregard certain section or that the franchisee will receive agreements that differ from the US franchise disclosure document. While in some cases the disclosures may be appropriate and correct, other disclosures will be inapplicable and potentially misleading. This is especially true where a more sophisticated franchisor has a different structure for its international franchising activities. And of course, the sophistication and language skills of international franchise prospects may differ widely. When handed a 400 page document with cover pages, state pages, state addendum and multiple exhibits and attachments, the tendency may be to ignore the entire document, or focus on the wrong sections.

The main pitfall of providing a US franchise disclosure document is that it is fairly common to see multiple differences between a franchisor's US offering and its international offerings. These are just a few of the types of differences that can arise:

- *The franchisor entity is different*

  Many US companies have domestic and international franchise companies for tax, liability, intellectual property and other reasons. Information focused on the US franchisor may be confusing or misleading, especially if the actually franchisor is barely mentioned in the US franchise disclosure document.

- *The ownership of the system and trademarks is different*

  As noted above, there are multiple reasons for different entity and asset holding structures, and statements in a US disclosure document regarding the entity that owns the marks and system may not be correct are likely more harmful than providing no information at all.

- *The agreement structure is different (direct vs. area representative vs. master franchising)*

  Many US franchisors follow an entirely different agreement structure internationally such that including and/or describing domestic forms may be confusing or misleading.

- *Financial statements are under US GAAP and potentially for the wrong entity*

  As noted above with respect the franchisor entity, the financial statements may be for a different entity that could be misleading if the size and net worth of the US franchisor and international franchisor are different. Also, it would be very rare for a US company to attempt to re-state financial statements to reflect the accounting standards in the relevant country.

- *The fee structures or amounts are materially different*

  While certainly not universal, many US franchisors charge higher amounts in their international transactions. Providing disclosures related to lower amounts and then charging higher amounts could be detrimental to the business deal as well as confusing and misleading to the franchisee prospect.

- *The initial investment is materially different (and may not be known by the franchisor for the particular country)*

  While it is typical for US companies to provide US initial investment information with caveats and disclaimers where there is a mandatory investment disclosure in an international disclosure document, most franchisors do so begrudgingly and so providing the information from a US disclosure without an express obligation to do so and without additional international-specific disclaimers could do more harm than good.

- *The supply chain is materially different*

  US franchisors typically take less of a direct role in the supply chain internationally, and the US disclosures may be irrelevant or confusing to an international prospect, especially

where they describe a group of vendors and opportunities that won't be available internationally.

- *The marketing program is materially different*

  US franchisors typically simplify their advertising and marketing requirements and obligations internationally such that descriptions of US based ad funds, coops and advertising councils may not be relevant internationally except perhaps in certain jurisdictions that are in close proximity to the US (such as Canada or perhaps Mexico).

- *The dispute resolution rights and obligations are materially different*

  Most US franchisors will use international arbitration in their international agreements even if they use their local courts in their domestic agreements. Further, some franchisors will use additional or different enforcement or security measures internationally, from liquidated damages to letters of credit that can be very important parts of a transaction, and are likely not described at all in a US FDD. One can imagine a scenario where the franchisee prospect remarks that they reviewed the 400 page US franchise disclosure document and never saw any mention of a letter of credit, yet it appears in the form of agreement the US franchisor provided to the international prospect.

- *Governmental approval, language, tax and other similar cross-jurisdictional issues are materially different*

  There are a number of material aspects to an international franchise transaction that are unique to cross border transactions and therefore would not likely be disclosed or addressed in a US disclosure document, including concepts such as withholding tax, duties and other types of tax issues, language issues, government approvals, commercial agency laws and visa/immigration issues.

3.2 Complying with a Non-Binding, Country-Specific Association Disclosure Obligation and/or Code of Ethics

Many counties have franchise associations akin to the US based International Franchise Association. While US franchisors have not generally gravitated to becoming members of the local franchise associations in the countries in which they have franchised, many of these associations have their own rules for membership that including compliance with a pre-sale franchise disclosure format promulgated by the association.

For instance, the German Franchise Code of Ethics, which is binding for members of the German Franchise Association, has certain disclosure obligations.[8] These disclosures include:

- information concerning the franchise concept;
- information concerning the franchisor's financial situation;
- information concerning the system headquarters, and the people possessing decision-making authority;
- details about any pilot operation;
- a profitability forecast, if available;
- the draft franchise agreement and the all annexures and accompanying agreements;

[8] see: • Guidelines of the German Franchise Association "Pre-contractual Disclosure" (English translation); http://www.franchiseverband.com/index.php?id=franchise-ethik-kodex0

- bank references;
- detailed information about memberships of commercial and/or national franchise associations; and
- detailed information about distribution channels for the franchise products and services.

Similarly, the British Franchise Association has its own code of ethics, but with a more generic disclosure framework. It has a set of Guiding Principles, as follows:

2. Guiding Principles

2.1 The Franchisor is the initiator of a franchise network, comprising itself and its individual franchisees, of which the franchisor is the long-term guardian.

2.2 The obligations of the franchisor: The franchisor shall:

- have operated a business concept with success, for a reasonable time and in at least one pilot unit before starting its franchise network
- be the owner, or have legal rights to the use of its network's trade name, trade mark or other distinguishing identification
- provide the individual franchisee with initial training and continuing commercial and/or technical assistance during the entire life of the agreement.

2.3 The obligations of the individual franchisee: the individual franchisee shall:

- devote its best endeavours to the growth of the franchise business and to the maintenance of the common identity and reputation of the franchise network
- supply the Franchisor with verifiable operating data to facilitate the determination of performance and the financial statements necessary for effective management guidance, and allow the Franchisor, and/or its agents, to have access to the individual franchisee's premises and records at the franchisor's request and at reasonable times
- not disclose to third parties the know-how provided by the franchisor, neither during nor after termination of the agreement

2.4 The ongoing obligations of both parties:

- Parties shall exercise fairness in their dealings with each other. The Franchisor shall give written notice to its individual franchisees of any contractual breach and, where appropriate, grant reasonable time to remedy default. Parties should resolve complaints, grievances and disputes with good faith and goodwill through fair and reasonable direct communication and negotiation.[9]

[9] https://www.thebfa.org/about-bfa/code-of-ethics

3.3 Preparing an International Wrap Disclosure Document

In the 1990's, some US franchisors were tempted to use a "wrap-around" FDD or international disclosure document in an effort to reduce the cost and time burden of compliance with disclosure laws, and then provide that "wrap" FDD to all prospects as a form of all-in-one disclosure satisfaction tool.[10]

In concept, a wrap FDD made some sense for a franchisor that was franchising into multiple countries because there was significant overlap between the requirements of these international disclosure laws. In theory, a wrap-around disclosure document is a uniform disclosure document for use throughout the world. By using the wrap-around disclosure document, a franchisor will necessarily provide more information than a particular country's disclosure law requires, but can also address each country's specific requirements via an addendum to the standard disclosure document.

The original thought was that a wrap-around disclosure document would produce time and cost savings, but as newer and more comprehensive franchise disclosure laws came into effect that mandated specific formats[11], the wrap lost favor as there was almost no practical way to comply with these newer, more comprehensive laws in a single document. In addition, a wrap-around disclosure document could lead to confusion, as more than likely it will include information specific to the franchisor's US operations (or the franchisor's international operations, but not in the same countries in which the wrap-around disclosure document will be utilized).[12] For example, information about a franchisee's initial investment that is based on a franchisor's US operations will not be useful in many countries where the cost of real estate, equipment and labor is sharply different from the US.

Ultimately, the wrap-around franchise disclosure document proved to be effective only in limited circumstances, such as where franchisors are franchising only in one geographic area (e.g., Latin America) and an attempt to cover Mexico and Brazil in a single document might make more sense due to the lack of formal disclosure formats in these countries and the relatively shorter and narrower scope of information to be disclosed. But for franchisors planning to franchise throughout the world, and given the influx of newer franchise laws and the trend to requiring specific format for local franchise laws, the utility of a wraparound international disclosure has been almost completely eviscerated over the last ten to fifteen years.

3.4 Preparing a Generic International Disclosure Document

For franchisors with an active international franchise program, an abbreviated franchise information memorandum or similar document is likely the most viable non-franchise disclosure law jurisdiction option since it can provide basic information regarding the international program, can be the initial basis for mandatory international disclosures documents and can ideally answer a lot of preliminary questions that would otherwise require hours of time spent by the sales team or lawyers answer questions related to issues that the franchisor may have readily available in a disclosure format.

There is of course a fine line to tiptoe when determining what type of information can and should be included in a general international disclosure document. Key topics that likely make sense to add include the following:

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[10] Andrew P. Loewinger and Michael K. Lindsey, International Franchise Disclosure Laws, at 3-4 (ABA Forum on Franchising 2002) (hereinafter International Disclosure Laws).

[11] Australia, Canada (provinces), Korea, Indonesia and Malaysia are just a few of the countries that mandate a specific disclosure format that does not lend itself to a wrap FDD.

[12] Chapter 7; International Franchising, Franchise Law Compliance Manual, 2011.

- *Franchisor entity information*

  Information on the franchisor entity such as name, date and place of formation is definitely important and easy to procure and disclose.

- *Franchisor and brand history*

  Any franchisor that has prepared a mandatory international disclosure document will have readily available disclosures regarding the brand history.

- *Key personnel*

  Franchisors must take care to avoid directly copying a US FDD's Item 2 disclosures if not the same franchisor entity or certain personnel are only relevant to the domestic or international programs, but information on the key personnel can be useful to prospects in any jurisdiction.

- *Initial and continuing fees*

  The fees payable to the franchisor is of course important to prospects, but is also something that could vary widely across different international jurisdictions so it may be difficult to capture in a generic international disclosure document without providing ranges that lessen the utility of the disclosure.

- *Agreement overview*

  Franchisors may use different agreements domestically and internationally, but may also use different agreement structures from international jurisdiction to international jurisdiction. For instance, a franchisor may elect to do direct franchises in a country that is geographically close or speaks English, and may elect to master franchise in a country that is geographically further away or has language barriers.

- *Territorial rights and obligations*

  International franchisees tend not to quite understand the nuances that US franchisors bring to their international franchise agreements in terms of territorial rights and restrictions, and US form retained rights provisions are ripe for confusion or ire in negotiations and/or if/when a franchisor elects to exercise retained rights for something like alternative venues or alternative methods of distribution. Most international franchisees believe they own the market so disclosures related to territorial rights and restrictions is definitely a viable topic for a generic international disclosure document.

- *Training*

  The nature and extent of initial training, opening assistance and continuing training obligations can be very important in an international transaction where distance, language, visa/immigration and time differences can make in-person or even telephonic international more difficult. International franchisees will definitely want to know and understand what they are getting in terms of training and service.

- *Unit counts*

  The current size and geographic distribution of the franchise system is fairly basic information, but it is actually difficult for some franchisors to collect and provide this information, especially if broken down into mandatory categories such as what you see in a US franchise disclosure document or some international franchise disclosure laws. That said, most franchisors should be able to provide last fiscal year based store counts and country information in a generic international disclosure document.

There are of course other topic areas that are more questionable for inclusion and have both pros and cons related to their inclusion:

- *Litigation history*

  Including US litigation history could potentially chill sales, is unlikely to be directly relevant to an international franchisee, and could be confusing if related to types of actions that do not exist in the local country. It would also be difficult to decide on what scope of disclosure should be included where there are no defined guidelines.

- *Bankruptcy history*

  Including US disclosures related to attenuated parents, predecessors or even personnel who are not involved in international franchising could potentially chill sales without providing any particularly relevant information to the prospective franchisee.

- *Initial Investment*

  Unless the franchisor has specific experience in the country, it may not be worthwhile to provide an initial investment chart based on US experience where no express obligation to do so exists. Each franchisor would need to determine how relevant and helpful such a chart would be to an international franchisee prospect.

- *Supply chain matters*

  The fact is that many US franchisors have not (and will not) dive deep into supply chain issues for a particular country unless/until a deal is close at hand, which may be too late, and could make generic disclosures related to the supply chain wrong, misleading or incomplete.

- *Financial statements*

  Financial statements of an entity that does not actually operate any units can in many cases fail to provide any useful information to the prospective franchisee, and this is particularly the case if a US franchisor uses a parent's financials in the US franchise disclosure document along with a guaranty, but won't be providing that guaranty internationally.

And finally, there are other areas that are unlikely to make sense in a generic international disclosure document:

- *Financial performance representations or earnings claims information*

  US franchisors have enough concerns with countries that regulate or even require some form of financial performance representations or earnings claims such that in most circumstances they would be best served by steering clear of making cross-border earnings claims unless under special circumstances where the franchisor has a clear history of direct operations or franchising in the country and can steer away from any type earnings claim that is based on the performance of US units.

- *Public Figures Disclosures*

  The utility of this US disclosure is likely long since attenuated in the US, much less being applicable or relevant in an international disclosure.

- *Existing and former US franchisee contact information*

  While contacting existing franchisees is a crucial and relevant exercise in the US among domestic prospects and franchisees, the differences between US and international franchise offerings and operations likely makes communications between US franchisees and international prospects an unappetizing option for franchisors. Communications between international franchisees may make more sense.

- *FTC mandated "domestic" disclosures*

  For obvious reasons, FTC Cover Pages and other mandatory US-specific disclosures hold little value internationally and have no place in a generic international disclosure document.

- *State mandated addenda and disclosures*

- As with FTC mandated US-specific disclosures, state-specific mandated disclosures hold little value internationally and have no place in a generic international disclosure document.

4. Conclusion

There is no specific right or wrong answer as to whether a franchisor should prepare and provide a form of international disclosure document in countries that do not have laws that specifically govern the offer and sale of a franchise. Instead, a franchisor's analysis and determination should be based more on the circumstances involving the franchisor and the franchise transaction at the time of contracting.

If a franchisor follows the same framework in all its international deals and can prepare and provide a useful generic international disclosure document, there may very well be good reasons for doing so. If a franchisor follows a more ad hoc international franchise process and tends not to follow the same structure from deal to deal, then the utility of a generic international disclosure document may be attenuated, or even do more harm than good. This is ultimately an assessment for the particular franchisor to undertake internally and with its legal team.

Most importantly, US franchisors must use common sense and put themselves into the shoes of the prospective franchisee when considering material events or occurrence that occur in and around the time of pursuing a specific international transaction. If there is some material fact that is known to the franchisor, but not known to the franchisee prospect and would not be discoverable with reasonable diligence, the franchisor should proactively consider providing that information to the franchise candidate in a formal manner and asking the franchise prospect to acknowledge receipt to hopefully cut off an

attempt to later claim the omission or lack of disclosure of the information was harmful, and that the franchise prospect would not have entered into the transaction had they known the information.

Of course, this presupposes that the franchisor has processes in place to allow for the franchisor's recognition and identification of potentially material facts, and implementation in the franchisor's international activities. This can be especially difficult in a larger system where domestic and international franchising may be separated and not everyone at the company is privy to the available information.

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