INTERNATIONAL FRANCHISING: WHY ATTORNEYS NEED TO KNOW THE LAWS IN OTHER COUNTRIES

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In many countries around the world, concepts that are common in the United States are considered exotic to the local populace. Furthermore, as more and more Americans travel abroad, they welcome the sight of a familiar brand from “back home.” As a result of these two factors, when U.S.-based franchisors seek to expand abroad, they often find a ready audience. In fact, many franchisors get their first taste of international franchising when they are approached by a potential franchisee, asking for the opportunity to obtain franchise rights to a particular country or region of a country. It is only later that the franchisor actually begins to focus on active development of franchises outside the United States.

What should U.S. counsel for a franchisor do when asked to assist with this type of international franchise relationship? One of the first and most important tasks is to identify competent local counsel that is fluent in English and is sufficiently familiar with U.S. legal concepts to be able to explain the differences between U.S. law and local law. Outside the United States, most countries do not have legislation that is specific to franchising. That is not to say, however, that the countries have no laws affecting franchising. In every country, there are laws of general applicability that will affect the franchise relationship. Prime among these are trademark laws, which every country has, and which inevitably affect franchising. Other generally-applicable laws that are likely to have an influence on franchising are tax laws (and tax treaties), laws relating to foreign remittances (or similar currency restrictions), sales agency laws, and laws regarding technology or know-how licensing.

These types of generally-applicable laws mean that it will be necessary to consider local laws any time a franchisor does business outside the United States, regardless of whether the host country has a franchise-specific law. It may be necessary to modify the franchisor’s U.S. form of franchise agreement or to create an entirely different form of agreement (e.g., a master franchise agreement with subfranchising rights). As a result, it is always advisable to have local counsel review and comment on the agreements proposed for use in the country, not only to determine if modifications to the document are necessary, but also to ascertain if there are provisions that would not be enforceable regardless of the level of modifications, or if there are alternative approaches to accomplish the same objective.

Franchise-Specific Regulation

The few countries that have franchise-specific legislation merely add an additional layer of complexity to this evaluation. Currently, only 13 countries specifically regulate franchising…

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(although in Italy and South Africa the local franchise associations have adopted codes of conduct that could be interpreted as establishing a standard of conduct for franchisors, including non-members of the association). Of these countries, the majority focus their regulation on disclosure, although several have laws that would be identified in the U.S. as “franchise relationship” laws. Many U.S.-based franchisors that begin franchising internationally use their domestic UFOC as a basis for international disclosure, supplementing that disclosure as necessary with a “wrap-around” document that adds country-specific information. There may be several advantages to this approach. Among them are the following:

(a) It is likely to be less expensive to prepare a “wrap-around” supplement to an existing domestic UFOC (or to a specially prepared internationalized UFOC) than to create an entirely new country-specific disclosure document.

(b) If the franchisor is new to international franchising, and does not have a dedicated staff of international franchising personnel, its employees are likely to be more familiar with the domestic UFOC, and therefore have less new information to learn for purposes of discussions with the franchise candidates.

(c) Depending on who the franchisee is, and where the sale is made (see below), the franchisor’s home-state franchise laws may still apply to transactions outside the U.S., requiring the disclosure of U.S. information even if the franchised unit will be operated outside the U.S.

(d) Even if not required by applicable law, a franchisee can make a claim that it was disadvantaged by not receiving information provided to U.S. franchisees, and some franchisors choose to avoid the issue by giving their international franchisees a domestic UFOC, even if no disclosure is required by the local country’s laws.

Applicability of U.S. Laws

Even when a franchise is granted for a location or territory outside the United States, U.S. law may still apply under at least some circumstances. Many franchises for non-U.S. operations are actually sold to U.S. citizens or residents. If the franchise agreement is entered into in the U.S., even if for an operation outside the U.S., both federal and applicable state franchise disclosure laws are likely to apply (for example, California law will apply to a sale made in California to a California resident, even if the franchised unit will be operated outside the country). Finally, at least one U.S. District Court has held (until reversed on appeal) that the FTC Rule governing franchising applies to “pure outbound” franchises (that is, a sale by a U.S.-based franchisor to a non-U.S. resident that plans to operate outside the U.S.). Nieman v. DryClean U.S.A. Franchise Co., Bus. Franchise Guide (CCH) ¶11,644 (S.D. Fla 1997), rev’d, 178 F. 3d 1126 (11th Cir. 1999). Consistent with the view taken by the 11th Circuit on appeal, the FTC, in its Notice of Proposed Rulemaking (published at 64 Fed. Reg. 57294), includes a proposed modification to clarify that the FTC Rule does not apply to that type of “pure outbound” transaction. Unless and until that change becomes effective, however, a risk remains that a court in another Circuit could hold as the District Court in Nieman did.
Countries Regulating Franchising

The countries outside the United States that currently have laws specifically regulating franchising are, in the Americas, Brazil, Mexico, Venezuela, and the Canadian provinces of Alberta and Ontario; in the Pacific Rim countries, Australia, China, Indonesia, Malaysia, and South Korea; and in Europe, France, Romania, Russia, and Spain.

The Americas. Brazil requires disclosure of a relatively modest amount of information to the prospective franchisee, and further requires that the franchise agreement (along with a certified translation into Portuguese and a list of trademarks) be filed with the Brazilian Institute of Industrial Property and registered with the Central Bank of Brazil. Mexico requires disclosure of a greater amount of information than does Brazil, and requires that the executed franchise agreement (along with a list of trademarks that the franchisee can use and the registration numbers of those marks) must be filed with the Mexican Institute of Industrial Property (no governmental approval of the agreement is required). In Venezuela, there are franchise-specific regulations that were issued under an otherwise generally-applicable law. Those regulations relate solely to the franchise relationship (rather than to pre-sale disclosure), and allow certain actions that would otherwise be considered anti-competitive under the general law (such as granting exclusive territories), provided that certain other provisions (such as price restrictions) are not contained in the franchise agreement. Although the Canadian federal government has no franchise-specific legislation, two provinces (Alberta and Ontario) do. Alberta’s law requires disclosure only, and specifically allows use of a UFOC from the United States, provided that the supplemental information required to be disclosed in Alberta is added. Ontario’s law, which is very new, has both disclosure and relationship provisions. While the answers to some questions under the Ontario law are not yet clear, it appears that it would be difficult to comply with some aspects of the Ontario disclosure requirements through the use of a document based on a UFOC with supplements (see Markus Cohen’s article in the February 2001 edition of Franchising Business and Law Alert – “The Disclosure Document Under The New Ontario Legislation: How Close Is It to UFOC?”).

Pacific Rim. Australia’s franchise law is essentially a disclosure law, although it does have a few relationship provisions. The regulations in China (which were promulgated and are administered by a quasi-governmental organization) require both disclosure and a pre-sale filing. Indonesia and Malaysia have quite comprehensive regulations, which require pre-sale disclosure and registration, and regulate many aspects of the relationship. South Korea’s law is focused on disclosure, but it has an unusual requirement: in addition to requiring disclosures about specific issues, the franchisor is also legally obliged to respond to written inquiries from the prospective franchisee for additional information.

Europe. The French law (which applies to commercial relationships including franchises) requires disclosure, but no filing or registration. Both Romania’s and Russia’s franchise laws affect both pre-sale disclosure and relationship issues. Spain’s law requires registration and disclosure, but does not regulate the relationship, once entered.

In addition, a study group of the European Union, called the “UNIDROIT Study Group of Franchising” has been meeting since 1999 in an effort to develop a model franchise disclosure
law. If UNIDROIT indeed publishes its recommended law, there is a possibility that additional countries will adopt disclosure laws, presumably patterned on the model law.

The prospects of additional growth lead many U.S.-based franchisors to consider franchising outside the United States. While there are many advantages to this type of growth, it is important to look carefully at the legal climate in any country in which a company intends to expand. Although only a relatively few countries currently regulate franchising per se, the laws in many countries are broad enough to affect many of the issues important to franchisors, so consultation of a qualified local counsel is very important, even in countries with no franchise-specific legal scheme.