

International Franchise Association
55th Annual Legal Symposium
May 7-9, 2023

Taking International Expansion to the Next Level: A Practical Guide to International Franchising

Ashley Graffeo
The Wendy's Company
Dublin, Ohio

Roman Kupchynsky III
Dickey's Capital Group
Dallas, Texas

Kevin Maher
Baker McKenzie
Dallas, Texas

TABLE OF CONTENTS

| | | |
|------|---|----|
| I. | Introduction: Understanding Your Goal | 1 |
| II. | Business and Legal Strategies for Expansion | 1 |
| A. | What is the Franchisor’s True Goal? | 1 |
| B. | The Act of Expanding Internationally – Assessing New Markets and Meeting the Business Goal..... | 2 |
| C. | Finding the Right Franchisee – Legal and Practical Considerations..... | 4 |
| III. | Overview: International Franchise Structures | 5 |
| A. | Area Development Agreement/Multi-Unit Franchise Agreement | 6 |
| B. | Area Representative Agreement | 8 |
| C. | Master Franchise Agreement..... | 9 |
| D. | Unit Franchise Agreement..... | 11 |
| E. | Joint Ventures..... | 12 |
| IV. | The Deal Process: Intake, Negotiations and Documentation..... | 14 |
| A. | Template Agreements..... | 14 |
| 1. | Internationalization / Customization | 15 |
| 2. | Key Legal Considerations..... | 15 |
| 3. | Choice of Law | 16 |
| a) | Local Law | 16 |
| b) | Franchisor’s Home Country Law | 17 |
| 4. | Dispute Resolution | 18 |
| a) | Forum | 18 |
| b) | Venue..... | 19 |
| (1) | Litigation..... | 19 |
| (2) | Arbitration | 20 |
| B. | Due Diligence | 20 |
| 1. | Country Diligence | 20 |
| 2. | Local Law Review | 21 |
| 3. | Candidate Diligence | 22 |
| 4. | Preliminary Deal Documents | 23 |
| 5. | Term Sheets..... | 23 |
| 6. | Letters of Intent / Memorandum of Understanding..... | 23 |
| 7. | International Disclosure Documents (IDDs) | 24 |
| 8. | Deposits..... | 24 |
| V. | Laws Affecting Franchising | 25 |
| A. | Franchise Disclosure Laws | 25 |
| B. | Franchise Registration | 25 |

| | | |
|------------|--|----|
| C. | Relationship | 26 |
| 1. | Dealer Laws | 26 |
| 2. | Commercial Agency Laws | 27 |
| D. | Competition Laws | 27 |
| 1. | Resale Price Maintenance | 27 |
| 2. | Non-Competition & Non-Solicitation | 28 |
| 3. | Exclusivity | 28 |
| E. | Compliance Laws | 28 |
| 1. | Anti-Corruption & Anti-Money Laundering | 28 |
| 2. | Sanctions and Embargoes | 29 |
| 3. | Human Rights & Environment | 30 |
| F. | IP Laws | 30 |
| 1. | Registration | 30 |
| 2. | Technology Transfer Laws | 30 |
| G. | Taxes | 31 |
| 1. | Withholding / Foreign Tax Credit | 31 |
| 2. | VAT | 32 |
| 3. | Income Tax | 32 |
| 4. | Other Taxes | 32 |
| H. | Exchange Control Laws | 33 |
| I. | Data Privacy & Cybersecurity | 33 |
| VI. | Conclusion | 33 |
| | Appendix A - International Franchise Structures | 1 |
| | Appendix B - International Franchise Disclosure and Registration Laws..... | 1 |

Taking International Expansion to the Next Level: A Practical Guide to International Franchising

I. Introduction: Understanding Your Goal

There is no one-size-fits-all approach to franchising your brand internationally. Every company has different goals, different resources, different risk tolerance levels and different cultures. A well-capitalized, multi-national, public company franchisor with thousands of units globally is likely to take a very different approach to expanding to a new country than a mid-sized regional franchisor. A fitness center franchise is likely to make different decisions about structures and markets than a car rental brand.

The first step in determining how to structure your brand's international franchise program is to make an honest self-assessment about your company and your brand. Looking at how other brands have successfully franchised in a particular market is an instructive and useful exercise, but do not take for granted that what has worked for other brands will work for your brand. You need to look behind what others have done to understand whether that approach is right for your brand and your company. As we will discuss below, there are only a handful of overarching structures for expanding internationally via franchising, but within each structure are important details and distinctions about how different brands might execute that structure.

Some brands will enter a market through a local subsidiary, set up a supply chain, open and operate company stores, and then begin franchising only after the brand has proven successful in the market. Other brands will offer franchises on a purely offshore basis, leaving the franchisee to set up the supply chain and prove the concept. Some brands require an 8-figure initial investment per unit with a 20-mile radius between units, while others have a very low unit-level investment but rely on heavy market penetration. Some brands require very strict controls on brand execution. Others are more flexible and allow for generous localization. These and many other factors should drive your strategy for expansion.

The goal of this paper will be to help you make a self-assessment of your company and your brand and use that information to determine the optimal structure for your brand and to create a process for execution in compliance with laws and industry best practices.

II. Business and Legal Strategies for Expansion

A. What is the Franchisor's True Goal?

Whether you are on the business side or the legal side, the core question that must always be asked is: what is the goal in choosing to expand a brand internationally? There are several perfectly acceptable answers to this question, but the franchisor must be honest with itself in answering this question. Failure to make an honest and introspective assessment of your brand's motivations can produce very unsatisfactory results, including large budget overruns across many departments, an incoherent strategy, inconsistent or poor brand implementation, wasted time and undue stress.

What are good reasons to expand internationally? There are many good reasons for brands to embark on international expansion, so the answer to this question is likely to vary from brand to brand. What's most important is that the goals of expansion match your companies resources, culture and long-term strategy. Is the key goal to simply sell as many franchises as possible and generate strong initial fee revenue in the short term without regard to long-term brand reputational issues? Is long-term cash flow from royalties more important than upfront cash? Is the expansion as much of a marketing exercise as a revenue-generating exercise? Or is the goal to increase brand equity over the long term and create a best-in-class franchise system for the benefit of the brand, the franchisees and customers alike? None of these answers are wrong. What's key to designing and implementing the right strategy is knowing what the goal really is and making decisions that best achieve those goals. Pursuing growth for growth's sake without a more coherent understanding of the drivers for that growth based on your brand's culture, ethos and resources is a perilous path. At the outset, all stakeholders in the business must understand that expanding internationally will be expensive and time-consuming no matter what the motivations are. Therefore, before investing the many human and capital resources needed to execute an international expansion, be sure your teams are aligned and honest about the true goals for expansion.

B. The Act of Expanding Internationally – Assessing New Markets and Meeting the Business Goal

Now that you've honestly assessed your goals for expanding internationally and have decided to move forward: how do you assess new markets with a view towards furthering those goals?

Many times brands seek to expand based upon inquiries received from interested candidates in foreign markets. While pursuing opportunities is not a bad thing, pursuing opportunities that don't align with a coherent strategy is fraught with risk and often leads to deal failure or worse harm to the brand in the new market.

Ideally, the business team will conduct market due diligence¹ in advance to determine what markets fit best with your brand and your brand expansion strategy considering the relevant market's characteristics, such as: demographics (i.e., is there a consumer base with sufficient disposable income for the brand to be successful); geography (i.e., can your brand provide the necessary support and training in the relevant market considering available resources); language (i.e., will your products or services, training materials, manuals and contracts need to be translated?); and culture (i.e., how will your products or services be received in the local market and will substantial localization be needed?).

Another key consideration will be whether a country has laws regulating franchises (i.e., disclosure, registration or relationship laws).² Compliance with franchise laws will

¹ See *infra* Section IV.B.1.

² See *infra* Section V.

affect the legal cost associated with doing a deal in that country and may also affect your legal liability if things don't go well. It will be important to factor in both the timing and cost of compliance into your overall budget when assessing each market for possible expansion and prioritize your growth strategy accordingly. These compliance costs should also factor in the setting fees for a particular market to ensure an appropriate return on investment.

In addition to franchise law compliance, the structure chosen by the franchisor can materially impact the cost and timing for market-entry. It's important to understand that expansion into certain markets may not make economic sense once all of the structuring and legal compliance steps are properly understood.³ A master franchise or joint venture structure can require a substantial upfront investment to prepare the necessary document. Layering franchise law compliance on top of structuring costs will add to the expense. At the same time, depending on your brand's resources, long-term strategy and financial projections, these compliance costs may be immaterial in comparison to the upside for the brand in a given market. What's crucial is understanding the potential costs and compliance obligations as part of the selection process for a given market rather than after a deal has been agreed.

The franchisor's honest self-assessment as discussed above should also play an important role in its market selection. In selecting markets or pursuing opportunities, a brand should always have a keen self-awareness as it relates to their operational readiness to successfully execute in a new market. Expanding into a market before the brand is ready can create lasting damage to the brand. Franchisors should be comfortable that they have the human and operational infrastructure needed to appropriately support the new market. The level of infrastructure required will vary greatly from concept to concept. Key questions that should be asked include:

- Will the expansion divert resources from other important company initiatives?
- Is there sufficient budget available to hire new employees or must current employees be redeployed to handle the expansion?
- What are the potential consequences to the brand if inadequate oversight and support are provided?
- Is there a suitable supply chain in the market?
- Who will be responsible for setting up the supply chain, the brand or the franchisee?
- How many markets can the organization successfully execute at one time?
- If the launch is successful, can we support accelerated growth?
- If the launch is not successful or the franchisee is not performing, how can standards be enforced and brand risk be mitigated?

All of these questions and more should be explored in selecting new international markets for expansion, but the ultimate goals of the business should be kept at the

³ The various available structures for market expansion by franchising are discussed in detail in Section III *infra*.

forefront of all decision-making to ensure that the strategy and the implementation are properly aligned.

C. Finding the Right Franchisee – Legal and Practical Considerations

The only thing that may be more critical than selecting the right markets for expansion may be selecting the right franchisees. International franchise transactions tend to be larger than domestic transactions, often covering an entire country and calling for dozens or even hundreds of units to be developed. As a result, there is generally greater risk and uncertainty involved in selecting international franchisees. As a result, a franchisor should employ an even higher degree of diligence in assessing whether it has the right franchisee partner in a market before undertaking the costs to expand to a new market.

Perhaps most obviously, a franchisor should be very comfortable with the financial health of its international franchisees. Simply knowing that a prospective franchisee has the ability to pay initial fees and has a decent chance to open a franchised location should not be a satisfactory measure of the franchisee's suitability. A failed launch in a market could significantly damage the perception of the brand in that market for many years. Therefore, not only should the franchisee demonstrate the ability to open a unit, but it also must have the financial wherewithal and sophistication to appropriately support the unit in accordance with brand standards to ensure its success. The franchisee should also have sufficient human and financial capital to continue development of subsequent units in accordance with the agreed development plan. Moreover, a franchisee that is not sufficiently capitalized and fails is more likely to accuse the franchisor of failing to provide appropriate support (be it construction, site selection, training, marketing or technology support), creating an enhanced legal risk to the franchisor beyond simple brand risk arising from a closed or poorly-run unit.

A franchisor should also feel very comfortable with the business acumen of its international franchisees. The prospective franchisee should be able to convince the franchisor why they are the best partner to take the brand into a new market. It's not simply about the franchisee's ability to pay the fees, but also to successfully execute the brand in the market over the long term. Their reputation, sophistication, resources and experience should make the franchisor comfortable that this franchisee will be an ambassador for the brand and contribute to the long-term growth and financial success of the franchisor not only in that market, but as a model for other markets that franchisor may be interested in pursuing.

The franchisor must also feel comfortable that a potential franchisee's principals and organization are a good fit for the culture of the franchisor's organization, brand and system. Domestically, successful franchisees come from many different backgrounds and professional settings. However, in an international setting, there are further cultural, language and business considerations involved than in a typical domestic transaction. Locating an international franchisee that truly understands your brand while also sharing your brand's values and vision is crucial to long-term success. There is no legal or business analysis to guide the assessment of potential franchisees. Rather, it requires

developing a relationship over time and learning about the potential franchisee in a meaningful way before taking the next step. It also requires being willing to “cut bait” if red flags arising during intake or negotiations. Mistakes in selecting franchisees can be very costly in many respects, so better to leave a potential mate at the altar than get married to the wrong franchisee.

III. Overview: International Franchise Structures

Once you have identified the main goals to be achieved and aligned on a strategy for your brand’s international expansion, you will then be able to discern the franchise structure (or structures) that best fulfill the business goals. There is no “objective best” structure that will work for every franchisor or for every international transaction. Rather, the chosen structure will be a function of the business objectives, franchisor policy, market forces, the business environment of the market, and even the goals of interested franchisee candidates.

The five main structures typically used for international franchising are: area development,⁴ area representative,⁵ master franchise,⁶ unit franchise,⁷ and joint venture.⁸ This section describes each structure and their respective advantages and disadvantages in an effort to help you select the structure that best meets your goals.⁹ Key factors that should influence your decision are the human and financial resources your brand has available to invest into each international market and the level of control which the franchisor wishes to maintain over development and operations in the market. Generally, a higher level of investment will be needed in order to maintain a higher level of control and support. Additional factors that may influence the choice of franchise structure to be used include local laws and regulations regulating franchising, intellectual property, and specific business sectors, in addition to local customs and cultural practices.¹⁰

Appendix A to this paper contains a high level summary of pros and cons of each international franchise structure from the perspective of the franchisor. We will discuss each structure in greater detail below.

⁴ See *infra* Section III.A

⁵ See *infra* Section III.B

⁶ See *infra* Section III.C

⁷ See *infra* Section III.D

⁸ See *infra* Section III.E

⁹ See also the following industry papers addressing international franchise structures: “International Expansion: The Toe in the Water Approach” from the ABA Forum on Franchising October 2019 (Mo Alturk, Robert A. Lauer, and Larry Weinberg); “From LOI to Closing: Getting an International Franchise Deal Done” from the ABA Forum on Franchising October 2014 (Kerry Olson, Frank Robinson, and Kendal H. Tyre); and “Basics Track: Expanding Internationally” from the IFA Legal Symposium May 2019 (Francesca Turitto, Donald P. Wray Jr., Larry Weinberg, and Tao Xu),

¹⁰ See *infra* Section V

A. Area Development Agreement/Multi-Unit Franchise Agreement

In an area development agreement (“ADA”), the franchisor contracts directly with the franchisee to develop multiple franchised locations, either directly or through an affiliate controlled by the area developer. ADAs typically include an agreed development schedule requiring that the area developer develop and sign franchise agreements for a minimum number of units in a specified timeframe in order to maintain their right to continue development and their exclusive rights to the area, if any. The term “area development” comes from the fact that the franchisor grants rights for development within a defined area. This area could be an entire country, multiple countries in a region, or a defined area (such as a city, state or province) within a single country.

The typical ADA does not directly grant operating rights to the area developer. Rather, the ADA grants the right to develop units in a defined area under separate unit franchise agreements to be signed before the opening of each unit. However, some brands use a hybrid approach to area development that combines the main concepts of an ADA into a franchise agreement that also grants operating rights. This type of agreement is commonly referred to as a multi-unit franchise agreement (MUFA). Under the MUFA approach, there is typically only a single agreement for the entire development area. The MUFA includes area development concepts as well as the concepts found in a typical unit franchise agreement, allowing the area developer to open and operate all units in the area under the same agreement. The single agreement MUFA approach is often used when local disclosure or registration requirements are triggered each time a unit franchise agreement is executed. The MUFA can also be easier to administer from a contracts management perspective than having separate agreements for each unit. The downsides of the MUFA approach as opposed to the traditional ADA approach is that it generally doesn’t easily allow the area developer the flexibility use separate entities for each unit, it makes it more difficult to address remedies on a unit-by-unit level rather than collectively, and it doesn’t as easily allow for unit-level customization of the terms of the unit franchise agreement. However, for brands with heavy market penetration, high unit turnover or lower unit investment costs, this approach is often preferred.

Key terms frequently included in an ADA or MUFA include:

- An area development fee;¹¹
- Exclusive or semi-exclusive development rights within a defined area;
- Development schedule (including number of sites and the timeline on which they are to be opened)

ADAs and MUFAs generally do not grant the area developer right to grant sub-franchises to third parties. However, like a master franchisee, an area developer is generally expected to provide support and infrastructure across their development area. Area developers will be expected to invest significant human and financial resources in

¹¹ Some brands will apply a portion of this fee to the initial franchise fee for each unit opened, whereas other brands will treat this as a fee for the development rights to the area and will charge a separate initial fee for the opening of each unit.

order to develop their entire development area and will generally be expected to carry-out responsibilities for locating sites, construction, training, marketing and supply chain development. These obligations are generally stronger if the area developer has exclusive rights, which is most often the case in international ADAs. Additionally, it is common for area developers to use different legal entities to sign each franchise agreement. This allows the franchisee to distribute operating liability among its many locations, but also to bring on minority investment partners in each franchisee entity. If minority investment is allowed under the terms of the ADA, franchisors should ensure that the ADA has provisions specifying the level of equity or voting control the area developer must maintain over these affiliates and retaining the right of the franchisor to consent to any third parties participating in the equity of the franchisee.

Typical franchisor responsibilities under an ADA or MUFA structure may include:

- Review and approval of sites proposed by the area developer;
- Initial and ongoing training and operational support across the entire development area;
- Supply chain support and approval of regional suppliers;
- Brand standards inspections; and
- Franchise disclosure and local law compliance.

Typical area developer responsibilities under an ADA or MUFA structure may include:

- Site selection;
- Construction and development;
- Supply chain development;
- Unit-level training and operational support (beyond the support provided by the franchisor); and
- Compliance with local law applicable to the business.

Because of these responsibilities, the ADA structure bears some similarities to a master franchise model;¹² however, due to the direct contractual relationship between franchisor and the area developer, the area development model is a better choice for franchisors seeking to maintain a higher degree of control over their brand, while benefiting from recruiting efficiencies (i.e., not needing to recruit a different franchisee for each unit), and leveraging the area developer's local market knowledge and relationships, which can support faster growth than unit franchise growth.

Because the typical area developer is also somewhat more sophisticated than a single-unit operator, an area development model is also a good choice for franchisors seeking to invest less capital and incur lower ongoing administrative costs (especially under the 'single agreement' approach). While this can deliver significant financial benefit to a franchisor, franchisors also run a higher risk if an area developer turns out not to be a strong operator or ultimately proves unable to satisfy the agreed development schedule.

¹² See *infra* Section III.C.

Therefore, it is critical to clearly define the remedies available to franchisor when operational or development obligations are not satisfied.

B. Area Representative Agreement

In an area representative agreement, the franchisor will contract with an area representative (or “development agent”), who will recruit franchisee candidates and provide support to franchised locations within a defined area.

Under an area representative structure, the franchisor will execute multiple agreements: (1) an area representative agreement with the development agent, and (2) unit franchise agreements or ADAs with the franchisees/developers recruited by the development agent. There is typically no direct contractual relationship between the development agent and the franchisee, unlike the master franchise structure. Some area development arrangements may also permit the development agent to act as a franchisee and develop in the area directly through a unit franchise agreement.

Key terms frequently included in an area representative agreement include:

- Initial fee paid by area representative for rights to the defined area;
- Fees payable to the area representative (commonly this entails a percentage of initial franchise fees paid by franchisees, and if the area representative provides ongoing services, a percentage of royalties collected from franchisees);
- Representative rights within the defined area (which may or may not be exclusive); and
- Development expectations (i.e., timing requirements, and any obligations to ensure quality development or provide ongoing support).

Typical franchisor responsibilities under an area representative structure may include:

- Final approval of franchisees presented by the development agent;
- Execution of franchise agreements for each unit; and
- Franchise disclosure to unit franchisees (which may be coordinated with the development agent).

Typical development agent responsibilities under an area representative structure may include:

- Franchisee candidate recruitment and screening;
- Site review and approval;
- Initial and ongoing training and operational support;
- Brand standards inspections; and
- Franchise disclosure (in coordination with the franchisor).

The area representative structure is a good choice for franchisors seeking less day-to-day involvement in the international market. A qualified development agent will have strong experience and connections in the local market, allowing it to facilitate franchisee recruitment and provide oversight for local operational issues. However, because of the franchisor's ultimate direct contractual relationship with the franchisee, franchisors have the ultimate responsibility for these obligations. As such, if the development agent fails to perform or the relationship sours, the franchisor should be prepared to step in to provide the necessary support to the local franchisees. Additionally, engaging with multiple, non-exclusive development agents may allow for accelerated growth in a market if the franchisor is comfortable delegating these core responsibilities to the development agent.

Franchisors are advised to look into applicable tax laws carefully when using the area representative structure. If the area representative constitutes an agent of the franchisor for local tax purposes, the franchisor could be subject to local taxation.¹³

C. Master Franchise Agreement

Under a master franchise agreement, the franchisor will typically grant a master franchisee the right to open locations directly and to further grant sub-franchise to third parties, all within a defined territory.

Under a master franchise structure, the franchisor will typically execute only one agreement: a master franchise agreement with a master franchisee. The master franchisee will in turn contract with sub-franchisees to own one or more sub-franchised units. There is usually no direct contractual relationship between the franchisor and the sub-franchisees.¹⁴ The master franchisee essentially functions as the franchisor within the master franchisee's territory.

It is common for franchisors to require master franchisees to either initially, or on an ongoing basis, operate some units itself. This requirement ensures that the master franchisee understands how to successfully operate the business in accordance with standards before it assumes the obligation to enforce operational requirements on the sub-franchisees. Benefits of this approach include confirmation that the master franchisee is invested in the brand's goodwill and success in the territory, as well as ensuring that the master franchisee has the necessary knowledge, skill, and experience to train and support sub-franchisees' ongoing operations. However, if the master franchisee is required to operate a significant percentage or number of units, this may also divert the master franchisee's resources away from supporting sub-franchisees' development and operations.

¹³ See *infra* Section V.G.

¹⁴ Sometimes a franchisor will require a triparty agreement or addendum to be signed among the franchisor, the master franchisee and a subfranchisee addressing what happens to the subfranchise upon termination of the master franchise agreement.

Key terms frequently included in a master franchise agreement include:

- Initial master franchise fee for the grant of master franchise rights to the territory;
- Fee sharing arrangements for fees paid by sub-franchisees to the master franchisee (i.e., subfranchisees pay royalties to the master franchisee and the master franchisee pays a portion of those royalties to the franchisor);
- Development schedule (i.e., the minimum number of sites to be opened and the timeline on which they must be opened); and
- Conditions of sub-franchise rights (i.e., is the master franchisee required to open a certain number of directly operated sites before it sub-franchises? Is the master franchisee required to continually operate a certain number or percentage of sites in the territory?).

The master franchise structure involves significant shifting of responsibility from the franchisor to the master franchisee. Therefore, a typical master franchisee will be expected to invest significant time and capital into developing the territory. The master franchisee must also have the human resources and presence in the territory to provide support to sub-franchisees and navigate local issues. Operating experience in the franchisor's industry or a similar line of business, local connections, and familiarity with local laws and customs are critical qualities to look for in a master franchisee. Master franchisees are typically required to pay somewhere between 60% to 25% of the fees collected to the franchisor. Depending on their experience, level of investment and responsibilities, master franchisees may negotiate the amount of royalties and other fees paid by sub-franchisees that they are allowed to retain.

Typical franchisor responsibilities under a master franchise structure may include:

- Training the master franchisee to operate under your system and to provide support and training to subfranchisees;
- Specifying the form of sub-franchise agreement to be used by the master franchisee;
- Final approval of sub-franchise candidates or locations;
- Providing brand standards for local market and approving modifications to the same by master franchisee for the local market; and
- Enforcing the master franchisee's rights under sub-franchise agreements if master franchisee fails to do so.

Typical master franchisee responsibilities under a master franchise structure may include:

- Sub-franchise candidate recruitment and screening;
- Initial and ongoing training and operational support for sub-franchisees;
- Modifying brand standards for local market, subject to franchisor approval (includes legal requirements, local customs or tastes, etc.)
- Brand standards inspections and enforcement of subfranchised units;

- Franchise disclosure to sub-franchisees; and
- Compliance with local laws and regulations.

The master franchise structure is a good choice for franchisors seeking to invest fewer resources (both financial and human) in developing an international territory. However, the franchisor must also be prepared to accept less control over the sub-franchised restaurants and local implementation and enforcement of brand standards, since the franchisor will not be in direct contract with most of its unit operators. Additionally, if the franchisor's relationship with the master franchisee expires, is terminated, or otherwise sours, the resulting disruption can have a substantial impact on the brand presence and reputation in the territory. When local law permits, it is advisable to make the franchisor a third party beneficiary of any sub-franchise agreements.

D. Unit Franchise Agreement

In a unit franchise agreement, the franchisor will contract directly with a franchisee to develop, own, and operate a single franchised unit, typically at a single specified location.

A unit franchise agreement a traditional franchise agreement for the operation of a unit under a franchise system with no larger development rights or obligations. Under a unit franchise structure, franchisors will enter into a single contract per location, such that franchisees that operate more than one unit for a brand must enter into a separate franchise agreements with the franchisor for each location.

Key terms frequently included in a unit franchise agreement include:

- Initial franchise fee;
- Royalties and marketing fees;
- Site selection and construction criteria;
- Brand standards;
- Supplier criteria; and
- Operational requirements.

With the unit franchise structure, the franchisor retains a high level of control, and retains all of the fees paid by franchisees, but the franchisor is also directly responsible for all of the day-to-day support of the franchisees' operations. The typical unit franchisee needs less capital and less business expertise, which means the franchisor will need to provide a higher level of assistance and training, and with multiple franchisees, this can lead to more complex administrative requirements.

Typical franchisor responsibilities under a unit franchise structure may include:

- Franchise candidate recruitment and selection;
- Site review and approval;
- Initial and ongoing training and operational support;

- Modifying brand standards for local market;
- Brand standards inspections and enforcement; and
- Franchise disclosure and local law compliance.

Typical franchisee responsibilities under a unit franchise structure may include:

- Site identification;
- Site construction;
- Operation of a single franchised location;
- Payment of initial and ongoing fees; and
- Compliance with brand standards.

The unit franchise structure is a good choice for franchisors who prefer to have a direct relationship with individual franchisees and a high-level of oversight of the franchised brand internationally. This structure is ideal for brands that have the resources needed to make the required in-market investments in employees, local supply chain, and other business functions. This can be difficult to fulfill on long distance, so it's common for a franchisor engaged in international unit franchising to create a local subsidiary in the market and maintain a local presence to support the franchisees. Because the unit franchise structure can lead to a slower development pace, it may not meet the needs of a franchisor who is looking to expand quickly.

E. Joint Ventures

In a joint venture, the franchisor will contract with a local “partner” to form a new joint venture entity (the “JV entity”) jointly owned by the franchisor and the local partner. The franchisor and local partner, as owners, share in the expenses and profits of the JV entity. The franchisor will often form a new affiliate to hold the interest in the JV entity in order to partially insulate itself from liability.

Under a joint venture structure, the franchisor and the local partner form the JV entity and enter into a joint venture agreement (this is often in the form of a shareholders' agreement, a partnership agreement or an operating agreement). The JV entity will then typically enter into an area development agreement, multi-unit franchise agreement or a master franchise agreement with the franchisor such that the JV entity becomes a franchisee or master franchisee. It not advisable to allow the JV entity to operate units without having some type of franchise agreement in place with the franchisor. Failing to have proper agreements may jeopardize the franchisor's IP rights for the market where the JV entity is operating or give the JV entity a claim to any improvements or modifications made to the system. In general, the franchise documents should be managed separately from the joint venture documents and employ one of the structures discussed above. The main purpose of the joint venture should be to allow the franchisor to participate in the equity ownership of the JV entity's local operations and have greater control over governance of the franchisee organization. Any sharing of intellectual property rights should remain in the franchise documents to be signed by the JV entity.

A key benefit of a joint venture structure is that it provides the franchisor with access to a local partner that can bring many of the same skills and knowledge to the table that an area developer or master franchisee would normally bring, but this structure allows the franchisor to make a financial investment in the business in exchange for voting and control rights at the franchisee level. Importantly, this also gives the franchisee the ability to participate in the bottom line of the business through dividends or distributions and not just receive a fee on a percentage of the top line sales.

Terms frequently included in a joint venture agreement include:

- Capital contributions by each party;
- Allocation of profits and losses;
- Decision-making authority (at a board and shareholder level);
- Services or other matters to be provided by each party to the JV entity;
- Management responsibilities; and
- Provisions dealing with how to manage deadlocks on key business decisions;
- Rights of first refusal, purchase options and other restrictions on transfer; and
- Termination and unwinding provisions.

Joint venture agreements are common when the franchisor and the local partner both make valuable contributions to the relationship, in addition to capital. The franchisor frequently contributes a license of its trademarks, brand knowledge and experience and other intellectual property. The local partner brings local market knowledge and experience to the table as well as local infrastructure in terms of management personnel and back-office support. That being said, the make-up of joint venture agreements can vary significantly based upon, among other things, the number parties to the joint venture, the level of capital contributed by each party and the level of knowledge and experience that the local partner brings to the table.

Typical franchisor responsibilities under a joint venture structure may include:

- Initial and ongoing capital investment;
- Granting of franchise rights under a separate agreement; and
- Participation in management and decision-making.

Typical local partner responsibilities under a joint venture structure may include:

- Initial and ongoing capital investment;
- Human resources and local presence;
- Management and back-office support functions;
- Knowledge of local territory (includes legal requirements, local customs or tastes, etc.)

The joint venture structure is a good choice for franchisors who want to profit directly from operations, but may not have the necessary local knowledge or presence to enter an international market directly or to be active in day-to-day operations. On the other hand, as part owner of the JV entity, the franchisor or its affiliate, may ultimately need to be more hands-on than initially expected and may need to contribute capital periodically as the business is developing. The joint venture structure can also be a good choice for franchisors who wish to retain a high level of control over the brand in an international market.

IV. The Deal Process: Intake, Negotiations and Documentation

Once you've determined the structure (or structures)¹⁵ that your international expansion will take, the next steps should be to first prepare template franchise documents, and then develop processes for market selection and candidate selection (as discussed in Section II above), market due diligence, candidate due diligence and deal intake and negotiations. Of course, in reality, it's very often the case that you won't have the opportunity to control the order in which these things happens, particularly for your brands first few international markets. Very often, the business will present a candidate or a market before you've settled upon a structure, prepared template documents or developed any type of process for due diligence.

A disciplined approach to strategy and planning is likely lead to a more well-conceived, stable and successful model for expansion--one that takes into account the most important aspects of your brand, the realities of your supply chain and support structure, and your financial and human resources. Given the opportunity, in-house counsel should advocate to allow for substantial lead-time (and budget) to develop strategy and corresponding documents and processes before taking the leap on international expansion. This is because significant discussion and iteration is needed to arrive at a strategy, documents and processes that reflect the input of key stakeholders in various areas of your company to include functional experts from construction, site selection, operations, training, supply chain, marketing, IT, risk, product development, among others.

A. Template Agreements

Putting together a strong suite of template franchise documents that are suitable for use internationally is an indispensable step in preparing to offer franchises outside of your home market. Depending on the specifics of your brand, this process could involve taking your brand's existing domestic franchise documents and "internationalizing" them or it may require starting from scratch with new form documents that will need to be customized for your brand.

¹⁵ Many brands will utilize more than one of structures described in Section III on a market-by-market or region by region basis depending on various factors, such as geographic proximity, candidate qualifications, local economies or supply chains.

1. Internationalization / Customization

The process of internationalizing your domestic franchise documents entails a review by qualified international counsel to identify the key terms and provisions that should be adapted for use in a cross-border agreement (but not necessarily for any specific foreign market). This process will generally require much more than a simple review of the legal terms to make sure they work in a cross-border context. It will also be critically important to review the key operational and commercial terms from your domestic agreement to ensure that the support, services, training, fees or other obligations or rights under the agreement can be feasibly and effectively delivered when the franchisee is located in a foreign country.

This process will require a critical review of the agreements with key business stakeholders to ensure that the franchise offering as contemplated by the domestic agreements is modified to reflect the brand's capabilities a cross border context. This analysis should focus both on the current state capabilities of your brand as well as a desired (and reasonably likely) future state. The terms should be drafted with sufficient flexibility to account for the current state and the envisioned future state, and, where it makes sense, to leave room for further evolution and developments. Experienced international franchise counsel can assist in critically reviewing both the legal and commercial terms in your domestic agreement and help think through the issues (including advising on what other similarly-situated brands are doing) to arrive at the right approach for your brand.

Of course, not all brands wishing to franchise internationally have an existing domestic franchise agreement. In fact, many brands expanding internationally through franchising operate exclusively through company-owned operations in their home market. Similarly, some brands that franchise in their home market may decide upon different model of franchising (for which it does not have existing documents) for its international expansion (e.g., unit franchising domestically vs. master franchising internationally). In these cases, you will be starting somewhat from scratch, but your counsel should be able to provide you with a strong starting point document that can be customized for your brand through a similar process as discussed above.

2. Key Legal Considerations

From a legal standpoint, there are a few important threshold decisions that you will need to make with respect to your template international franchise documents that will dictate the general process for reviewing and customizing your template documents for use in each market. The preferred approach will vary from brand-to-brand for different reasons, but most brands want to achieve as much consistency and predictability as possible with their template documents while recognizing that a certain amount of tailoring will be necessary for each new market.

3. Choice of Law

One of the initial gating decisions you will need to make is to choose what law will govern your template agreements. This decision will drive many other decisions about the structure and process for your international deals.

a) Local Law

Some brands will elect to have local laws (*i.e.*, the laws of the jurisdiction where the franchised location will be located) govern their franchise documents. In some cases, this is the most logical choice. For example, certain brands may enter a market directly, set up a local entity to act as the franchisor and support the franchisee from the local market and even operate alongside its franchisees.¹⁶ In such a case, the choice of local law to govern is the most natural choice. But such a structure is quite rare and is typically only employed by the largest brands who are able to invest heavily in a franchise market and take a very long-term view. The large majority of brands expanding into new markets do not take the same approach or have the same level of capital to invest in each new franchised market. Rather, most brands expanding to a new market will (at least initially) be supporting the brand remotely or regionally and will not have a legal presence in the franchisee's local market.

The upside of choosing local laws to govern your franchise documents is that it's usually welcome by franchisees because it's the law with which they are most familiar. Some local counsel will even advise you that this is the best approach for purposes of enforceability and local enforcement.¹⁷ In some cases, having local law govern is mandated by local franchise or other laws.¹⁸ Further, even if you choose to have your brand's home country laws govern the franchise documents, there may be certain types agreements (e.g., a joint venture agreement or a promissory note) that should or must be exceptions to this general rule due to the nature of the underlying agreement or the impracticality of using foreign laws for those agreements.

If your brand is planning to expand into multiple foreign countries and legal support will generally be managed from the parent company in the brand's home office, then this approach has a number of downsides, including a lack of consistency, increased cost, and greater unpredictability. If you are charged with managing contracts for dozens of jurisdictions, it is unwieldy at best to keep track of dozens of forms of agreements that have been heavily revised for compatibility with local laws in dozens of jurisdictions. Often, it is significantly more costly to have local counsel revise the agreements for full compatibility with local laws for each new country as opposed to the much lighter review for mandatory local law issues that's most typically done when the agreement is governed

¹⁶ See *supra* Section III.

¹⁷ Experienced and earnest franchise counsel in several jurisdictions will strenuously advise franchisors against using the local laws of their country to govern the franchise agreement due to onerous laws that may apply or a lack of reliable court precedent.

¹⁸ The Philippines Technology Transfer Law requires use of a Philippines law to govern. Ontario's *Arthur Wishart Act* and other Canadian provincial laws require that local laws govern matters arising under these franchise laws.

by foreign laws. There's also a strong degree of predictability in interpretation and enforceability that's afforded by having the same law govern all (or most) of your international documents.

b) Franchisor's Home Country Law

In the majority of cases, brands will choose to have the laws of their home country apply to their international franchise agreements. As partly explained above, this approach has numerous benefits. The key benefit being ease of administration for brands that are expanding to multiple foreign countries that will be primarily supported from the franchisor's home country (particularly with respect to the legal, finance and tax functions).

For in-house counsel, the ability to have a consistent set of franchise documents for all countries that they know well and are comfortable with has myriad benefits, particularly when there may be dozens of different countries involved and hundreds of agreements. From a contracts management perspective, it becomes too cumbersome for in-house counsel to keep track of the local law implications of every market where a brand has a presence. Fortunately, the majority of countries that are viable markets for expansion will generally respect a choice of foreign laws to govern contracts with a local party as long as there is a sufficient nexus to the chosen law (such as it being the home market of one of the parties to the agreement). In many markets, the choice of a neutral country's laws will also be respected even without a demonstrated nexus.

Similarly, the cost of having agreements revised to be governed by local laws (in terms of legal fees and the time needed to implement) can be prohibitive depending on how compatible the local market's laws are with the laws of the franchisor's home market.¹⁹ When using home country laws to govern the franchise documents, it's typical to ask local counsel to review the agreement with an eye only to mandatory points of local law that will apply regardless of the choice of governing law. This standard of review tends to greatly reduce the number of changes required to be made by local counsel such that the main changes will go to issues of public policy, such as, among other things, franchise relationship laws, competition laws, usury laws and certain waivers and limitations of liability. This allows for a greater degree of predictability among agreements in different countries because (generally speaking) the changes required from a local law standpoint tend to focus on similar types of issues and do not require substantial re-drafting of clauses to comply with local law requirements from which the parties may opt out by choosing foreign governing law.²⁰

¹⁹ Going from a common law jurisdiction (e.g., New York) to another common law jurisdiction (e.g., Singapore) may not be a heavy lift. However, going from a common law country to a complex civil law country (e.g., Germany) is a complicated process.

²⁰ It's worth noting that several countries like Australia and Belgium have recently enacted fairness in contracting laws that may apply despite the choice of foreign law and can require more substantial revisions to the agreement to address concepts like fair notice, commercial reasonability and just cause in various clauses.

On the other hand, if the legal system of your brand's home country is not reliable or is unfavorable, you may not want to have your home country laws apply across the board. In this case, rather than having the franchisee's local laws apply, it may instead make sense to choose the law of a neutral jurisdiction that has a well-developed and business-friendly legal system, such as England, Singapore or certain states in the United States.²¹ This approach should provide most or all of the benefits described above in terms of consistency, cost and predictability.

A key caveat to this approach described above is that brands coming from civil law countries (where agreements tend to have much less detail than common law style agreements) will have a more difficult time using their agreements in a common law country than *vice versa*. This is particularly true for non-U.S. brands entering the U.S. market where registration of the franchise agreement in several important states will be require registration with state regulators who will closely review the contracts and may raise concern with a foreign governing law or the lack of specific details found in the agreement.

4. Dispute Resolution

In addition to selecting a choice of law to govern your brand's franchise agreement, you will also need to determine the forum and venue for dispute resolution. Naturally, the considerations involved in choosing the dispute resolution forum and venue are closely tied to the considerations at play when choosing governing law as discussed above. In most cases, the approach taken with respect to governing law will often gravitate your decision-making on dispute resolution in one direction or the other.

a) Forum

The first choice with respect to dispute resolution will be the choice of forum--i.e., in what jurisdiction will your dispute resolution proceedings take place?

While it is theoretically possible to choose local governing law of Country B (the franchisee's home jurisdiction) and have dispute resolution in Country A (the franchisor's home jurisdiction), such a mismatch is not advisable for a number of practical and procedural reasons. Chief among these is that the local tribunal (be it a court or arbitral body) will not be familiar or qualified to rule on foreign law and will therefore typically require expert testimony from qualified legal expert on the chosen law. This is not only cumbersome, but it can also add significantly to the cost and complexity of the proceedings. Moreover, this mismatch adds an unwelcome level of uncertainty and unpredictability in the outcome of the case over and above the general uncertainty one might expect from a dispute resolution proceeding.

In some cases, a neutral forum may make sense as a negotiated resolution. However, any such concession should be mindful of the geography and practicality. A

²¹ Read: Not California.

Canadian franchisor based in Toronto agreeing to have arbitration in New York City when its documents are governed by Canadian law may not be too difficult to manage given the strong similarities between U.S, and Canadian laws, the common language, the short travel distance and the ready availability of qualified Canadian law experts. On the other hand, having a Tokyo as the forum for a Canadian law governed agreement would be undesirable for all the opposite reasons.

As such, a very strong rule of thumb should be for the dispute resolution forum to match the jurisdiction of the chosen law, with only rare and well-considered exceptions.

***b)* Venue**

After determining the forum for dispute resolution, the venue for hearing disputes must be determined. Outside of the cross-border context, litigation is favored over arbitration in many jurisdictions because arbitration generally does not allow for appeals and because arbitration tends to be more expensive. In the cross-border context, however, arbitration has gained favor due to the benefits provided by the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, more commonly known as the “New York Convention.”

(1) Litigation

Court litigation is likely most appropriate in template international franchise agreements when the local law of the franchisee has been selected and the franchisor submits to a forum in the same jurisdiction. The key advantage to this approach is that it is most often the fastest, most direct, and least expensive way to obtain and enforce a judgment against a franchisee.

Outside of this context, however, there are myriad disadvantages to using litigation for cross-border agreements. In particular, there are few treaties available related to the enforcement of foreign court judgements. While there are certain bilateral and multilateral treaties relating to recognition and enforcement of foreign judgments, there is not a widely-accepted global treaty like the New York Convention applicable to the recognition and enforcement of foreign court judgments. In fact, the United States is not a party to any treaties relating to the recognition and enforcement of foreign judgments.

The result is that, in many cases, whether a foreign court judgment will be enforced against a party (whether the franchisee or the franchisor) in their home country will require a recognition and enforcement proceeding in local courts, which can only begin after a judgment has been obtained through the courts of the chosen forum. Not surprisingly, this is not a uniform process, so every country has different requirements for recognizing foreign awards. In many countries, this entails a reciprocity analysis as to whether the judgments from the country in which enforcement is sought are generally recognized by courts in the jurisdiction where the judgement was rendered. This type of factual analysis by a court as a precursor to enforcement is naturally fraught with risk and uncertainty. As such, it would be unwise to proceed with using court litigation as the means for dispute

resolution on a cross border contract without thoroughly researching and understanding whether there is a judgment enforcement treaty between the countries in question and, if not, whether courts from the countries in question routinely recognize awards from each other's courts.

(2) Arbitration

In comparison to litigation, there is generally a greater degree of certainty in enforcing arbitration awards for cross-border agreements because the New York Convention has been adopted by 172 countries and counting, including essentially every country of relevance to most franchise systems. This near global acceptance of the New York Convention makes arbitration a far more versatile venue for disputes than litigation for cross-border contracts and has benefits regardless of the forum chosen to hear the dispute.

Enforcing an arbitration award through the New York Convention can be a lengthy process and each country will have its own process for recognition of the award through the treaty. Despite this, arbitration awards are still preferable as a general rule for cross-border disputes because, as discussed above, the ability to recognize and enforce foreign court judgments is unpredictable at best and, in many cases, simply not possible.

As such, most brands should default to using arbitration in their template international franchise agreements with limited exceptions, some of which are discussed above.

B. Due Diligence

Now that you have template documents setting forth your preferred or standard terms, the next step is to prepare for franchise deals in specific markets. In an ideal world, you'll have the time develop an expansion strategy and select the markets that are best suited for your brand geographically, culturally and demographically. However, very often, it seems that the business team will only tell you that they are considering certain market after they've already begun speaking to a candidate in that market. At this point, you will want to proceed quickly to prepare preliminary documents²² and commence due diligence both on the market and on the potential candidate.

1. Country Diligence

A first step in conducting country due diligence is to understand the legal landscape for franchising in the chosen market. Locating qualified local counsel in the chosen market is critical. If you have international franchise counsel, they will have a rolodex of local counsels who have experience representing franchisors expanding to their jurisdictions and will be familiar with the issues that are most important for brands to know and understand before coming to a particular market.

²² See *infra* Section IV.e

An approach for conducting country due diligence used by many systems is to have a standard new market questionnaire completed by local counsel. International franchise counsel can assist you in preparing the questionnaire, but the idea is to set forth key questions about the local laws in the country relating to franchising and relating to the particulars of your brand. For example, a typical new country questionnaire will ask, among other things, about (i) franchise disclosure, registration or relationship laws,²³ (ii) non-franchise laws that may be broad enough to capture franchising (such as dealer laws, commercial agency laws and technology transfer laws),²⁴ (iii) competition laws,²⁵ (iv) taxes that may apply to the remission of royalties and other fees back to the franchisor's home country,²⁶ and (v) other laws that may affect the particular business in which the brand is engaged (e.g., laws specific to the restaurant, hotel, retail, entertainment or other applicable industry).

Armed with the information gleaned from country due diligence, you will be in the best position to advise your business team on the legal limitations in the relevant market and any modifications that may need to be made to the franchise offering or the system in that market and, potentially, about opportunities that may not be available in your brands home market (such as greater latitude on pricing or non-competition clauses, etc.).

2. Local Law Review

After country due diligence has been completed (or, very often at the same time depending on how far a deal has progressed), the next step will be to have local counsel review your template international franchise agreements to incorporate necessary changes under local laws. The changes to the agreement are likely to cover some of the areas addressed in your new country questionnaire, but also issues presented by clauses in your agreement that were not covered by your preliminary country due diligence (e.g., changes to penalty interest, liquidated damages or indemnities) but that may be required for compliance with local laws.

The standard of review applied by local counsel will depend greatly upon the choice of governing law in your template international franchise agreements. If you have taken the more typical approach of using your brand's home country law to govern with arbitration governing disputes, your instructions to local counsel can be more narrow. In this case, the remit of local counsel should be to confirm that the local jurisdiction will respect your choice of governing law and, if so, to limit their review to matters of public policy or other mandatory local laws that will apply notwithstanding your choice of foreign law to govern the agreements.

If, on the other hand, your template agreements will have the franchisee's local law governing, the standard of review for local counsel will be broader and will require a

²³ See *infra* Section V.a through c. for details about these laws.

²⁴ See *infra* Section V.c and V.f.

²⁵ See *infra* Section V.d.

²⁶ See *infra* Section V.g.

more detailed review to ensure that the agreement matches all requirements of local law and industry standards. Typically, but not always, this level of review requires more changes than a review for mandatory laws only. This will depend on the similarity in legal systems between your home country laws and that of the target market (e.g., common law vs. civil law, highly developed vs. emerging markets).

3. Candidate Diligence

In addition to country due diligence, it's critically important to also conduct due diligence on the franchisee candidate. Due diligence is important for business and commercial reasons as well as legal reasons. We will discuss the legal imperatives for conducting due diligence in detail in Section V.E. *infra* and will focus only on the commercial reasons for conducting due diligence here.

While expanding to a new market may be an exciting prospect, it's also a very large investment of time and resources for a brand with an uncertain return on investment. Depending upon how your brand compensates your international development team for sourcing and signing new candidates, you may often find that your business team is engaged in negotiations with candidates that are unqualified or otherwise pose certain risks to the business. A disciplined approach to expansion should dictate that at least preliminary commercial and reputational due diligence on candidates be carried out early in the process to avoid wasting time and money pursuing an unqualified or unsuitable candidate.

Credit checks are very useful tools for determine financial qualifications. Regrettably, however, credit checks outside of the United States and certain other highly developed markets are either unavailable or unreliable. This is due to the fact that some countries do not have a developed system for tracking creditworthiness or due to heightened privacy laws limiting the collection or sharing of data. This may require the collection audited financial statements, if available, and a level of self-reporting by the candidate that may include references from banks or other reliable sources.

Reputational checks on a franchise prospect are also useful in candidate screening. These checks can often be completed by local counsel using desktop resources. This is particularly helpful when gathering information where there is not a common language or alphabet, which makes internet searches from your home market impractical or impossible. Another option for this type of search is to engage a third party background search firm²⁷ that can conduct detailed due diligence locally from various available sources, including local interviews, government records and other public sources. These searches can be rather expensive but tend to be much more in-depth than what can be gleaned from a desktop search. Therefore, depending on the concept

²⁷ Kroll, Navigant, Steele are examples of international firms that do this work, but each firm has different levels and qualities of capabilities in different markets so using the same firm globally may not always yield the best results. Another point to consider, if there is sensitivity to the underlying transaction, is using your outside international counsel to order the background check under a *Kovel* arrangement to maintain the confidentiality of the results.

and the profile of the franchisee, some brands will only request a background check from one of these firms if there are red flags or questions that come up in the context of desktop searches. On the other hand, some brands will obtain a third party background check for all candidates because of the nature of their concept or the level of investment to be made in the franchisee's business.

Finally, it will be important to conduct due diligence on the franchisee's legal entity to ensure that the entity's ownership is the same as has been represented by the candidate. In many cases, the business team will have discussions with a particular group, only to realize later that there are outside investors or other parties involved in the ownership of the proposed franchisee entity. As such, it will be important to confirm with the candidate the legal name of the franchisee entity and the name of all shareholders of the franchisee entity all the way up to individual owners or a publicly-traded company.

4. Preliminary Deal Documents

Often times, when the business team presents a new deal to you, there may have been preliminary discussions about economics and other commercial points, but there may not have been a detailed discussion around the particulars of various key legal and commercial points to proceed confidently knowing that there's a meeting of the minds. From a process and budgeting standpoint, the use of preliminary deal documents is helpful to ensure that the main components of a deal are agreed before spending your limited budget to conduct detailed due diligence or revising and localizing your template franchise agreement for a particular deal.

5. Term Sheets

A term sheet is typically the most basic preliminary document used in negotiating the parameters of an international franchise deal. The benefits of using a standard term sheet over a more detailed letter of intent or memorandum of understanding is that they are more easily negotiated by business people before involving the legal team. A term sheet is almost always expressly non-binding. Many times, a term sheet will not even be signed by the parties to avoid having to go through internal approvals or risk having claims of a binding agreement. However, if sufficiently detailed, a term sheet that is found to be acceptable to both sides is a solid starting point to determine whether common ground exists on key legal and commercial points before moving forward with detailed due diligence in drafting.

6. Letters of Intent / Memorandum of Understanding

In comparison to a typical term sheet, a letter of intent is a more formal but still brief legal document containing language describing the key agreements of the parties on the main commercial terms. Like a term sheet, however, most letters of intent are generally non-binding in nature. In fact, letters of intent will often expressly state that they are non-binding with the exception of certain boilerplate terms dealing with exclusivity, confidentiality and dispute resolution.

Unlike term sheets, letters of intent are generally always signed by the parties and tend to indicate a more formal preliminary agreement on the terms of the deal than a term sheet. Often times, the terms letter of intent and memorandum of understanding are used interchangeably and may generally refer to the same type of document. However, as a generalization, memorandums of understanding are more likely to have binding terms and are sometimes thought of as a true agreement pending negotiation of a more definitive agreement. For this reasons, using a letter of intent may be more appropriate for most international franchise transactions, though it may be a distinction without a difference depending on the binding nature of the document.

7. International Disclosure Documents (IDDs)

Another document that is often used in the preliminary stages of discussions with a candidate is an information document commonly referred to as an international disclosure document or IDD. An IDD is a voluntary disclosure document prepared by a brand to provide basic information to candidates about the franchisor, the system, the franchise agreement and the related fees and investments. IDD's are typically modeled after the mandatory franchise disclosure documents or FDD's that are required under many countries laws,²⁸ but, because IDD's are voluntary, a franchisor is able to structure an IDD to provide only the information it believes to be most relevant or important. The IDD may also satisfy some or most of the requirements for certain countries where FDD's are required. In fact, in lieu of preparing a country-specific FDD for certain markets, many brands will provide their IDD with a country-specific addendum to add any missing information that may be required in an FDD under a local franchise disclosure.²⁹

8. Deposits

One initial key question during the intake process is whether to take a deposit from a prospective franchisee. As outlined above, there can be substantial expense involved in moving forward with a transaction in a new market. Deposits can be useful to gauge the seriousness of the prospective franchisee and help the franchisor decide whether or not to make the necessary investment to move forward. If the prospective franchisee resides in a country which does not have disclosure laws, then it likely makes sense for a franchisor to accept a deposit to mitigate its risk and cost because the deposit is likely non-refundable and can be applied to cover at least part of the franchisor's cost in pursuing the deal. In countries with franchise disclosure laws, however, the collection of a deposit (or a non-refundable deposit) may not be permitted prior to providing the disclosure document to the prospect. Therefore, while a deposit is recommended to be part of the standard in-take process for an international deal, it's important to check with counsel to determine when and whether a deposit may be collected and, if collected, whether it may non-refundable.

²⁸ See *infra* Section V.A.

²⁹ This approach will not work for countries that have a promulgated format for FDD

V. Laws Affecting Franchising

As your brand enters each new market, it will be important to work with international counsel and qualified local counsel to determine the laws in each market that affect franchising. There are franchise-specific laws and regulations in about 35 countries (and growing), but even in countries without laws specific to franchising, there are laws that affect the franchise relationship. As part of your due diligence process,³⁰ you will need to familiarize yourself with these laws and, where necessary, adapt your franchise documents or practices accordingly.

A. Franchise Disclosure Laws

Franchise disclosure laws are the most common type of franchise laws. In general, these law will require the disclosure of certain types of information in writing to a franchisee. The franchise disclosure document or FDD typically must be provided to a franchisee a certain number of days before signing the franchise agreement or accepting any payment. The number of days varies from country to country and, in certain countries, accepting payment will not trigger a disclosure requirement.

Attached to this paper as *Appendix B* is a list of franchise disclosure laws globally as well as the detail of when disclosure must be provided. Some countries will require that an FDD follow a promulgated format, while other countries do not even specify the types of information that must be disclosed. In most countries with a franchise disclosure law, the provision of an IDD with a country-specific addendum will satisfy the necessary disclosure requirements.³¹

B. Franchise Registration

In addition to disclosure, several countries also require the franchisor to register with a government agency. The registration requirements vary, with some countries requiring only registration of certain details of the franchisor, other countries requiring registration of the FDD and other countries requiring registration of the franchise agreement (or both the FDD and franchise agreement).

Some registration laws will require registration before a franchisor may offer or enter into franchise agreements in the country³², while others do not require registration until after a franchise agreement has been signed.³³ The length and complexity of the registration process will also vary with some countries having a rather ministerial

³⁰ See *supra* Section IV.d.

³¹ See *supra* Section IV.e.iii.

³² E.g., Korea's Fair Transactions in Franchise Business Act, Act No. 6704, May 13, 2002, amended by Act. No. 18113, Apr. 20, 2021 (S. Kor.); the franchise laws of various U.S. states (California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, South Dakota, Rhode Island, Virginia, Washington, and Wisconsin).

³³ China's and Saudi Arabia's franchise disclosure laws require registration only after execution of a franchise agreement.

process³⁴ and other countries undertaking a thorough review and comment on the registration materials before approving the registration.³⁵

It's important to be aware generally of what countries require franchise registration and whether the registration must occur before signing an agreement because the process may take months and delay a potential franchise transaction.³⁶ In other cases, even where registration occurs after signing the franchise agreement, a lengthy registration process may impact your ability to receive payments from the franchisee.³⁷

C. Relationship

There are components of certain franchise laws that also govern the franchise relationships beyond merely requiring disclosure or registration.³⁸ Generally speaking, these laws will apply extra-contractually to govern specific issues like terminations and transfers or to impose implied duties of reasonableness or good faith and fair dealing.

Outside of the franchise context, there are also certain industry laws that may apply to franchise relationships due to the breadth of the underlying statute. These laws are generally categorized as dealer laws or commercial agency law.

1. Dealer Laws

There are several countries, primarily in Latin America and the Caribbean,³⁹ with laws governing dealer-principal relationships. In principle, these laws were crafted to protect dealers of products (like cars, machinery and equipment) who have invested heavily in an inventory of product and have built up the goodwill of the brand in the market on behalf of the principal. As a result, these laws typically provide that dealer arrangements may only be terminated for just cause and require that substantial compensation to be paid by the principal to the dealer in the event of a termination with just cause.⁴⁰ Although most franchise relationships typically would not be classified as dealer relationships, these laws are often drafted broadly and in some cases will even

³⁴ Australia implemented a register of franchisors in 2022. Also, Brazil has a intellectual property license registration requirement that is not specific to franchising (discussed in *infra* Section IV.f.) where a copy of an FDD receipt page is typically requested as part of the registration process for franchise agreements.

³⁵ See *supra* note 32.

³⁶ *Id.*

³⁷ China's registration process is currently delayed for foreign franchisors, in some cases taking longer than a year. This can affect a local franchisee's ability to make payment if questioned by the remitting bank. In Brazil, the outbound remission of foreign currency has been restricted for payments or royalties failing prior registration of the agreement with the Brazilian Central Bank.

³⁸ E.g., various U.S. state laws, Canadian provincial laws and Australia's franchise law.

³⁹ Fortunately, due the ratification of the Dominican Republic Central America Free Trade Agreement (aka DR-CAFTA), the impact of these laws has largely been muted in certain countries where both parties are from countries who have signed on to DR-CAFTA. The parties to DR-CAFTA include the United States, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic..

⁴⁰ The Commonwealth of Puerto Rico's Law 75 (Title 10, Chapter 14, Sections 278 through 278d of the Laws of Puerto Rico, 10 L.P.R.A. 278 278d); Dominican Republic's Law 173 of April, 1966.

capture services-based franchise agreements as well as franchise concepts involving the sale of products. Certain of these laws may require that the agreement be registered with a government agency in order for the protection to apply.⁴¹

2. Commercial Agency Laws

Commercial agency laws are very similar in nature to dealer laws. While there are commercial agency laws in many jurisdictions, the commercial agency laws that are construed to cover franchise relationships are primarily found in Middle Eastern countries.⁴² Like dealer laws, these laws generally protect the local party from termination without good cause and will impose compensation for a termination without good cause. In some cases, these laws will also provide the registered agent with exclusive rights to a brand for the entire country. Most of these laws require that a commercial agency agreement be registered with a government agency in order for the local party to benefit from its protections.⁴³ Registration under most of these laws also requires translation and notarization of the franchise agreement prior to registration. Fortunately for franchisors, the onus generally falls on the agent (or franchisee in this case) to make the filing and there's typically no consequence for failing to register other than the franchisee not being entitled to receive the benefits of the law. Accordingly, many franchisors will avoid registration under the commercial agency law by refusing to notarize and translate the franchise agreement.

D. Competition Laws

The antitrust or competition laws of many countries will also apply to franchise relationships as they relate to, among other things, pricing, territorial restrictions and non-competition covenants.

1. Resale Price Maintenance

It is commonplace for competition laws to limit a franchisor's ability to dictate the price at which a franchisee's products or services are sold. In most cases, the franchisor may dictate maximum pricing that a franchisee may charge as this is often viewed as being a pro-consumer practice, but many jurisdictions will prohibit a franchisor from dictating the minimum price that a franchisee may charge for goods and services. Franchisors must be careful not to include language in their franchise agreements suggesting that the franchisor has power to influence pricing in a way that would violate local competition laws.

⁴¹ See Dominican Republic's Law 173 of April, 1966.

⁴² See, e.g., the United Arab Emirates Federal Law No. 18 of 1981; Kuwait's Commercial Agencies Law No.13 of 2016; and Qatar's Commercial Agents Law No. 8 of 2002

⁴³ A notable exception is Kuwait's Commercial Agency Law which directly applies to franchise agreements and will apply regardless of whether the agreement has been registered.

2. Non-Competition & Non-Solicitation

The competition laws of many countries will also limit the scope or breadth of non-competition clauses. These limitation generally apply to post-termination non-competition clauses rather than in-term covenants.⁴⁴ Other countries have constitutional limitation on non-compete clauses making them of questionable enforceability.

Similarly, many countries limit a franchisor's ability to impose non-solicitation or no-poach covenants on franchises as these covenants are seen as restricting the right of a workers to control their employment. This is an area that has come under increasing scrutiny of late in many countries. Franchisors may consider removing these types of clauses from their agreement altogether to avoid issues with the changing legal landscape with respect to these clauses.

3. Exclusivity

Competition laws may also limit the grant of exclusivity to franchisees in some cases. For example, the European Union's competition laws will not allow a franchisor to restrict a franchisee's ability to sell passively outside of its territory. In other words, the franchisee must always be free to accept unsolicited orders from customers even if they are located outside of the franchisee's territory or in an area reserved to the franchisor or another franchisee.

E. Compliance Laws

There are a large and growing number of a laws that can be lumped together under the umbrella concept of "compliance." These laws generally put the onus on companies (including franchisors) to know who they are conducting business with (i.e., their franchisees) under the auspices of limiting and preventing practices like money-laundering, aiding and abetting terrorism, or supporting the economies of rogue states. Also falling in this umbrella category are laws that require companies not to conduct business with parties engaged in forced or child labor or other human rights abuses.

1. Anti-Corruption & Anti-Money Laundering

Many jurisdictions have adopted broad laws prohibiting the payment of anything of value to a public official in connection with obtaining or retaining business.⁴⁵ Some of these laws also prohibit commercial bribery where a government official is not involved.⁴⁶

⁴⁴ Note the European Union competition rules limit in-term non-competes to 5-years.

⁴⁵ See, e.g., the U.S. The Foreign Corrupt Practices Act of 1977 (FCPA), Pub. L. 95-213, 91 Stat. 1494 (1977), 15 U.S.C.; UK Bribery Act 2010.

⁴⁶ See UK Bribery Act 2010.

In addition, many countries have also enacted laws or regulations relating to the laundering of money and the funding of terrorist or criminal activities.⁴⁷

As a result of these laws, it's critical not only that franchisors include express provisions in their contract requiring compliance with these laws, but also that franchisors conduct appropriate due diligence on franchisee candidates to ensure that neither the franchisee candidate nor its direct or indirect owners (or their respective family members) are government officials and that they are not owned by a state-owned enterprise. This generally entails obtaining copies of the franchisee's corporate documents identifying who the shareholders or owners of the franchisee entity are. If there are owners that are also companies, then the same process should be repeated until a public company or natural person is reached. If a government entity or person is discovered in the ownership chain, this does not mean that a franchisor cannot proceed with the transaction, but it will be important to understand the role of government officials involved in managing the franchisee and to put in place appropriate training or safeguards to ensure that a violation of anti-bribery rules does not take place during the course of the relationship.

To ensure compliance with requirements or government agency expectations under anti-money laundering laws, franchisors should also be running checks against relevant government databases to ensure that neither the franchisee candidate or its direct or indirect owners are listed on any government watch list, such as the Specially Designated National list maintained by the United States Department of the Treasury's Office of Foreign Asset Control or OFAC.⁴⁸

In connection with both anti-corruption and anti-money laundering laws, it's also important for franchisors to provide appropriate training and education both of its corporate staff and its franchisees of the importance of being aware of these laws and of the severe consequences that can result even from unintentional violations of these laws. Importantly, certain government agencies responsible for enforcing these laws have established policies of leniency where companies have taken reasonable and appropriate steps to adopt policies and procedures for complying with these laws, which generally include procedures for conducting due diligence and training.

2. Sanctions and Embargoes

Several countries have also instituted sanctions and embargoes that may prohibit a franchisor from selling franchises into certain countries or to certain individuals or industries within a country. Determining whether sanctions may apply is an important part of early stage country due diligence.⁴⁹ For example, the United States has adopted sanctions or embargoes on Iran, Syria, Cuba, the Sudan and Russia. In many cases, brands will be prohibited from directly or indirectly doing business with parties located in these countries, but there are some exceptions so it will be important to consult with a

⁴⁷ See *Uniting And Strengthening America By Providing Appropriate Tools Required To Intercept And Obstruct Terrorism (USA Patriot Act) Act Of 2001, Public Law 107-56, 107th Congress.*

⁴⁸ See <https://ofac.treasury.gov/specially-designated-nationals-and-blocked-persons-list-sdn-human-readable-lists>

⁴⁹ See *supra* Section IV.d.i.

qualified trade sanctions expert if your company is proposing to enter into a franchise transaction that includes a sanctioned country, even if the sanctioned country would only be included as a right of first refusal.

3. Human Rights & Environment

Many countries have also recently adopted laws and regulations requiring companies to actively monitor their suppliers and business relationships and make disclosures or impose requirements with respect to certain human rights matters. As such, it is more and more common to see specific contract clauses prohibiting or addressing matters such as child labor, forced labor and human trafficking.

As an example, the European Union has recently adopted the Corporate Sustainability Due Diligence Directive requiring that companies of a certain size identify and prevent adverse impacts of their activities on human rights and the environment. Initially, these laws are only set to apply to larger companies, but this directive and others like it are part of a growing trend globally. As a result, it is becoming more and more important for franchisors to include specific provisions in their agreements addressing human rights matters and to conduct due diligence on their franchisees and suppliers to ensure compliance throughout their “value chain”.⁵⁰

F. IP Laws

Because a key element of a franchise agreement is the license of a trademark, franchise agreements often also implicate the intellectual property laws of certain countries, including laws requiring registration of trademarks, license agreements or the franchise agreement itself.

1. Registration

In several countries, the license of a trademark found in a typical franchise agreement is unenforceable unless it has been registered with the local trademark office.⁵¹ In some cases, this registration requirement can be satisfied using a short form agreement rather than registering the entire franchise agreement. In some countries, the license of pending trademarks or marks for which an application has not yet been filed is unenforceable, which may hinder your brand’s ability to enter that market.⁵² It will be important to understand whether any IP registration requirements will apply at an early stage in market due diligence so that you can determine whether your brand is able to satisfy the applicable requirements.

2. Technology Transfer Laws

⁵⁰ See the EU’s Corporate Sustainability Due Diligence Directive (“CSDDD”)

⁵¹ E.g., Russia and certain CIS countries.

⁵² E.g., Indonesian law does not recognize pending trademarks, which can prevent franchise registration.

Certain countries also have laws commonly known as technology transfer laws. These laws are often broadly construed to cover franchise agreements.⁵³ Technology transfer laws can impose onerous requirements on franchise agreements, such as mandatory local governing law, mandatory dispute resolution venue, limitations on royalty rates, and restrictions on non-competition covenants. The failure to comply with these laws may cause your franchise agreement to be considered null and void under local law. Compliance with technology transfer laws often entails revising the agreement to exclude any clauses not permitted under the law and registering the agreement with the local technology transfer board.

G. Taxes

Different types of taxes may apply to franchise agreements depending on the jurisdiction in question. The taxes that apply will vary depending on both the jurisdiction where the franchisor is located and where the franchisee is located. In some cases, double taxation treaties between the franchisor's home country and the franchisee's home country can also lower or eliminate the amount of applicable taxes.

1. Withholding / Foreign Tax Credit

The most common tax applicable to payments under franchise agreements is a non-resident income withholding tax. These taxes are generally viewed as a proxy for the local income tax that would otherwise have been payable by the franchisor if it were a tax resident of the franchisee's home jurisdiction. Typically, a franchisee is obligated to withhold from a payment to the franchisor an amount equal to the applicable withholding tax. For example, if there's a 10% withholding tax in the franchisee's home jurisdiction and there's a \$100 payment due under the franchise agreement, the franchisee would be required to deduct \$10 from the payment and remit a net amount of \$90 to the franchisor.

Many times, franchisor's will include what is commonly referred to as a "gross-up" clause in their agreements. In short, a gross-up clause shifts to the franchisee the burden of paying withholding taxes by increasing the amount payable such that the net amount payable to the franchisor is the same as what it would have been had no tax been applied. Using the above example, the \$100 payment would be increased (or grossed-up) to \$111.11 [i.e., $\$100 \div (1 - 0.1)$] such that the net amount payable after applying the 10% withholding tax would be \$100 [i.e., $\$111.11 * 0.9$].

If a gross-up clause is not used, franchisor's may be able to claim a foreign tax credit under their home country laws for the withholding taxes deducted from payments to the franchisor. The availability of these credits will vary depending on the tax laws in the franchisor's home country. If the franchisor plans to rely on taking the foreign tax credit, the franchisor should ensure that the franchisee provides appropriate

⁵³ Philippines and Nigeria both have onerous technology transfer laws that are broadly construed to apply to franchise agreements.

receipts from the taxing authorities in the franchisee's home country to substantiate the tax credit on the franchisor's tax return. An express obligation to provide tax receipts should be included in the tax provisions in the franchise agreement.

2. VAT

Aside from withholding taxes, many countries will also have a value added tax system that may apply to payments made under franchise agreements. Most countries will allow the franchisee to apply what's commonly-known as a reverse charge mechanism so that the VAT does not need to be charged on the royalty. However, in some countries, the tax authorities will require a non-resident franchisor to bear the burden of VAT and require that the franchisee deduct this amount from payments to the franchisor.⁵⁴ In some cases, exemptions to VAT can be claimed by franchisors through filing with the local tax authorities.⁵⁵ Typically, VAT charges are not eligible for foreign tax credits like withholding taxes.

3. Income Tax

In almost all countries, merely having a franchisee in a particular country does not create a taxable presence in that country for the franchisor absent the franchisor taking other actions that may create a taxable presence.⁵⁶ The country of Kuwait is a notable exception to this general rule. The taxing authorities of Kuwait take the very aggressive position of asserting that cross-border franchising into Kuwait by itself creates a taxable presence for the franchisor in Kuwait. Franchisor's with franchisees in Kuwait are required to file an annual tax return in Kuwait and pay taxes on their Kuwait-sourced income. This is onerous as it typically requires hiring a local accounting firm to prepare and file the tax return, which adds an additional cost to having a franchisee in Kuwait that should be factored into market selection.

4. Other Taxes

Aside from withholding taxes and VAT, some countries have other miscellaneous taxes that apply to payments under franchise agreements. A notable example is Brazil, which imposes state and municipal taxes on payments of royalty fees. It is not uncommon for franchisees to attempt to deduct these added taxes from payments to the franchisor, but a properly drafted tax provision (including a gross-up clause) should ensure that the burden of these taxes are shifted to the franchisee.

⁵⁴ Brazil imposes various level of taxes, including municipal taxes, IOF, CIDE assessment that may not be creditable.

⁵⁵ The Philippines will impose VAT on royalty payments, but franchisors may apply for an exemption from this treatment.

⁵⁶ Some example of activities that may create a taxable presence include creating a local entity, having local employees or having a fixed place of business in the franchisee's market.

H. Exchange Control Laws

Getting paid is obviously one of the main reasons that a franchisor enters into a franchise agreement in the first place. However, some countries have exchange control regimes in place that restrict the outbound remission of funds to foreign franchisors. In some cases, the exchange control rules will set limits on the royalty rates that can be charged by franchisors under franchise agreement. Notable countries with strict exchange control rules include Brazil, China, India, Nigeria, South Africa and Venezuela. Failing to understand these requirements upfront can prevent the franchisee from being able to pay the franchisor after the agreement is signed. As such, it's important for the franchisor to understand any applicable exchange control requirements at an early stage and ensure that the franchisee will be able to comply with the applicable requirements and pay the amounts agreed upon in the franchise agreement.

I. Data Privacy & Cybersecurity.

Many countries around the world have now adopted data privacy rules governing the collection, processing and use of individual's personal data. These protections extend to individual franchisees, their employees and customers of the franchisee. Many franchise systems are data intensive and require that franchisees share all types of customer data with franchisors. In many cases, the data collected is limited to sales data that does not contain personally identifiable information about the franchisee's customers or employees. However, larger systems are more and more likely to have loyalty programs that apply across borders. Loyalty programs and related applications typically entail the collection of sensitive personal data such as dates of birth and credit card information. Collection of this type of data is heavily regulated in many countries and failure to comply with applicable requirements can draw heavy fines and liability on the franchisor and franchisee alike. Accordingly, it's important for franchisor's to spend time considering the type of data that it really needs to collect from its franchisees, their employees and their customers in order to ensure that appropriate agreements are entered into with respect to the rights that each party will have to data that is collected and that each party complies with the requirements of applicable privacy laws in collecting, using and storing the data covered by these laws.

VI. Conclusion

As discussed at the outset, there is no one-size-fits all approach to structuring an international franchise program. Each system is different, each country is different and each franchisee is different. However, with proper planning and by maintaining a disciplined approach, in-house counsel can institute processes and procedures to make the overwhelming task of managing a global franchise system more manageable. Understanding your business team's strategy and desires is a critical first step, but that should be followed by an honest self-assessment of what can be accomplished given the human and financial resources available. From there, determining the appropriate franchise structure (or structures) that suit the business strategy is a necessary next step. Thereafter, working with international counsel to develop a standard suite of international

franchise documents and put in place processes for country due diligence, candidate due diligence, negotiation and execution will help you be prepared for what hopefully comes next: your brand's world domination!

Appendix A - International Franchise Structures

Appendix A contains a summary of pros and cons for franchisor, of each international franchise structure described in this paper.

A. Area Development

| Pros | Cons |
|---|---|
| High level of control over brand | Harder to recruit area developers with sufficient resources/sophistication |
| Leverage franchisee's local knowledge to support faster growth | Requires more resources than master franchise or area representative model |
| Recruiting efficiencies | Exclusivity provisions limit flexibility in the defined territory |
| Economies of scale / fewer franchisor resources needed for each new unit opened | Poor performance by area developer can damage brand on a wider scale than a unit franchisee |
| Area development fee paid upfront | Franchisor still needs to understand applicable laws/customs |
| No fee splitting (as with master franchise) | |
| Easier to terminate than master franchise | |

B. Area Representative

| Pros | Cons |
|--|--|
| Moderate control over brand (direct contract with franchisees) | Less control over operations (supported by area representative) |
| Leverage area representative's local knowledge to support faster growth | Sharing income (royalties, initial fees) with area representative |
| Fewer franchisor resources needed/day-to-day overseen by area representative | Franchisor risks being liable for area representative's actions as its 'agent' |
| Initial fee paid by area representative | Poor performance by, or loss of, area representative can lead to increased franchisor obligations and damage brand on a wider scale than a unit franchisee |

C. Master Franchise

| Pros | Cons |
|---|--|
| Lower capital investment and other resources from franchisor | Less control over brand and operations |
| Leverage master franchisee's local knowledge to support faster growth | Exclusivity provisions limit flexibility within identified territory |

| | |
|---------------------------------------|--|
| Initial fee paid by master franchisee | Poor performance by, or loss of, master franchisee can lead to increased franchisor obligations and damage brand on a wider scale than a unit franchisee |
| | Shared fees between franchisor and master franchisee |

D. Unit Franchise

| Pros | Cons |
|--|--|
| High level of control over brand | Slower growth |
| Easier to find lower capitalized franchisees | High level of investment of time and capital |
| No fee sharing | Lower initial fee compared to other models |
| | Franchisor still needs to understand applicable laws/customs |

E. Joint Venture

| Pros | Cons |
|--|---|
| High level of control over brand | Complex business structure can result in higher legal and administrative overhead |
| Less franchisor capital required than unit franchising | More franchisor capital required than typical franchise structures |
| Leverage JV partner's local knowledge to support faster growth | Risk of increased liability due to direct involvement in development |

Appendix B - International Franchise Disclosure and Registration Laws

| <u>Country</u> | <u>Disclosure Timeframe</u> | <u>Registration Required?</u> |
|--|--|---|
| ARGENTINA | Prior to execution of franchise agreement. | No. |
| AUSTRALIA | At least 14 days before: (i) entering into a franchise agreement (ii) entering into an agreement to enter into a franchise agreement, (iii) the making of any nonrefundable payment by the franchisee, or (iv) any renewal or extension of an existing franchise agreement. | Yes. |
| BARBADOS | None. | Yes. |
| BELGIUM | At least 30 days before: (i) entering into a franchise agreement (or amendment) or (ii) the payment of any consideration by the franchisee. | No. |
| BRAZIL | At least 10 days before: (i) entering into a franchise agreement or any preliminary franchise agreement, or (ii) the payment of any kind of fee by the franchisee. | Not under franchise law, but the franchise agreement must be registered with the Central Bank and trademark office. |
| CAMBODIA | None. | Yes. Notarized copy of Franchise Agreement must be recorded for it to be enforceable. |
| CANADA (ONLY ALBERTA, MANITOBA, NEW BRUNSWICK, ONTARIO AND PRINCE EDWARD ISLAND) | At least 14 days before: (i) entering into a franchise agreement or (ii) the payment of any consideration by the franchisee. | No. |
| CHINA | At least 30 days prior to execution of franchise agreement. | Yes, franchisor must register within 15 days following first sale in China. |
| FRANCE | At least 20 days prior to execution of franchise agreement. | No. |
| INDONESIA | Final franchise agreement and disclosure to be provided at least 14 days prior to execution of franchise agreement. | Yes, pre-sale registration of franchisor and disclosure document required. Franchisee must also be registered. |
| ITALY | At least 30 days prior to execution of franchise agreement. | No. |
| JAPAN | Prior to execution of franchise agreement. Does not apply to all types of franchise agreements. | No. |

| <u>Country</u> | <u>Disclosure Timeframe</u> | <u>Registration Required?</u> |
|----------------|--|---|
| KOREA | At least 14 days prior to payment of any fee or execution of franchise agreement. | Yes, pre-sale registration of disclosure document and franchisor required. |
| LITHUANIA | None. | Yes, but requirement may be waived by the parties. |
| MACAU | Reasonable time prior to execution of franchise agreement. | No |
| MALAYSIA | At least 10 days prior to execution of franchise agreement. | Yes, pre-sale registration of franchisor and franchise agreement are required. |
| MEXICO | 30 business days prior to execution of franchise agreement. | Yes, summary of franchise agreement must be registered. |
| NETHERLANDS | At least 4 weeks prior to payment of any fee or execution of franchise agreement. Any amendments to franchise agreement during this period must be favorable to franchisee. | No. |
| NIGERIA | None | The agreement must be registered with the National Office of Technology Acquisition and Promotion. |
| PHILIPPINES | None. | To be valid, the agreement must be pre-cleared under the Technology Transfer law. |
| ROMANIA | Prior to execution of franchise agreement. | No. |
| RUSSIA | None. | Yes, relevant trademarks must be registered with trademark authorities. |
| SAUDI ARABIA | At least 14 days prior to (i) execution of franchise agreement or (ii) payment of any fees to franchisor. Disclosure must be in Arabic. | Yes. FDD and Franchise Agreement must be filed within 90 days of signing. Annual filing for FDD within 6 months of fiscal year end. |
| SOUTH AFRICA | At least 14 days prior to execution of franchise agreement. | No, but Reserve Bank registration may be required. |
| SPAIN | At least 20 business days prior to (i) execution of franchise agreement or pre-contract or (ii) payment of any fees to franchisor. | No. |
| SWEDEN | Well before (in ample time) execution of franchise agreement. | No. |
| TAIWAN | At least 10 days prior to execution of franchise agreement. | No. |
| THAILAND | Yes. Prior to entering into the franchise agreement. | No. |

| <u>Country</u> | <u>Disclosure Timeframe</u> | <u>Registration Required?</u> |
|----------------|--|--|
| TUNISIA | 20 days prior to execution of franchise agreement. | No. |
| VIETNAM | At least 15 days prior to execution of franchise agreement. | Yes, franchisor must register with government prior to selling franchises. |