International Franchise Association
53rd Annual Legal Symposium
May 15-17, 2022

Basics Track: International Expansion

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AUTHORS' NOTE

"Basics Track: International Expansion" has been a recurring workshop at the International Franchise Association ("IFA") Legal Symposium, as a "bridge" program for the IBA/IFA Joint Conference that follows the next day. In the drafting of this paper, we chose to revise, update, and augment the IFA paper originally prepared by Mark Siebert, Adiya Dixon, and Alan Greenfield in 2016. We also consulted and incorporated select parts from the IFA papers prepared by Marc Mushkin, Dominic Mochrie, and Robert Smith in 2015, and Lisa Greenlees, Debi Sutin, and Kendal Tyre in 2017. We want to express our gratitude to all of these authors, and those who helped them (Jennie Hinkle and Matthew Miller for the 2016 paper, Diana Vilmenay-Hammond and Keri McWilliams for the 2017 paper).

IFA 52ND ANNUAL LEGAL SYMPOSIUM
BASICS TRACK: EXPANDING INTERNATIONALLY

A. INTRODUCTION

If you are reading this, you are likely entertaining the idea of expanding your franchise system beyond your home country borders and setting out down the path of international growth for the first time. Franchising internationally is an attractive opportunity for businesses seeking growth with reduced startup investment costs, minimal G&A expense and reduced liability exposure. Additionally, while COVID-related travel restrictions have created obstacles for franchisors in meeting candidates or supporting franchising, franchising internationally is still easier than it was in the past. With the proliferation of the internet and social media like Facebook, Twitter, Instagram, Snapchat and LinkedIn, domestic brands have a wider reaching platform for marketing their concepts than ever before. Instead of deploying their own personnel to a new territory, brands can now post their own advertisements, either directly or through the use of "influencers" and have those advertisements liked, shared, retweeted or favorited many times over. The ability to market this way increases a brand's global awareness, which may help in attracting franchise partners and customers alike.

In spite of the geopolitical uncertainty of the times, opportunities for global expansion abound in both developed and emerging markets. Developed markets offer the benefit of solid infrastructure necessary to support the real estate, banking and supply chain needs of your business as well as the legal framework supportive of franchising. While competition in these territories may be more difficult and robust, later entrants in these markets may benefit from a sophisticated consumer base and the ability to learn from the prior mistakes of others.

Emerging markets, too, offer tremendous opportunity for growth. While not typically offering the stability of developed markets, these markets often offer relatively low amounts of competition and potentially a clear path to the market. Importantly, these markets often offer large, young populations with a growing middle class, important demographics for most international franchising.

Over the course of this paper, we will present a few key considerations for franchisors looking abroad, whether a franchisor has already established a presence in another country, or is preparing for its first international venture. After presenting how best to assess readiness for international expansion, this paper will provide some key considerations before a franchisor takes the first step, including the importance of due diligence and partner selection, as well as some tips for approaching those critical tasks. This paper will then discuss key deal points, including structure, deal terms, and protection of intellectual property. Finally, we will conclude with a discussion of franchise and other applicable laws around the world.

The goal of this paper is to arm readers with the fundamentals to enable them to make their first (or second) international push a successful one.

B. ASSESSING READINESS: ARE YOU READY TO EXPAND INTERNATIONALLY?

While most international expansion initiatives start with high hopes, the reality can be quite daunting. The franchisor aspiring to successfully go global needs to have the ability to replicate the most salient components of its domestic system in a new market, all the while navigating the legal, conceptual, cultural, supply chain, tax, and economic differences of one or more international markets. Your ability to navigate this will ultimately determine success.

All too often, the neophyte international franchisor begins their journey reactively, when an unsolicited offer for their franchise rights in some distant country comes in via one or more electronic means. And knowing little about the country and even less about the potential partner, these ill-fated franchisors rush headlong into a business endeavor that they know little about with a new franchisee who often knows even less. The allure of being a "global franchisor" and the promise of initial fees is simply too great.

The more successful franchisors take a more rational proactive course. Once they are sure they are ready for international expansion, they will target specific countries or regions after careful analysis and planning. Through targeted research and a robust vetting process these franchisors will identify and screen prospective candidates. And, perhaps most importantly, they will understand that the training and support received by that international partner will be the key to each party's long term success.

Preparation is paramount in this effort. As a first step, the franchisor must carefully assess whether or not it has sufficient human and financial resources to establish an expansion plan that will allow it and its new franchisees to succeed – without sacrificing the performance of its domestic franchise efforts.

The following factors can help determine a system's readiness to go global.

1. Does it fit the corporate goals?

Like domestic franchising, the initial fee that is received by the franchisor will likely prove to be mostly a cost recovery vehicle after the expenses of due diligence, contract negotiation, trademark protection, training, and initial support have all been factored into the equation. Internationally, these costs can vary signficantly by country and can be material. This reality is made all the more evident once the franchisor realizes that the long term costs of international support also can be significant, while the ramp-up period is often longer than domestic franchising. The franchisor with international aspirations is therefore well advised to be sure that international franchising aligns well with – and certainly does not frustrate – its short term goals before making the leap.

The allure of having an "international brand" is not enough to justify expansion. Before taking what is likely to be the most consequential step in the brand's history, the initial questions the franchisor should ask are:

- Are we “going international” as a part of a well-thought-out long-term plan for the company, or are we simply reacting to an unexpected offer?

- Will the international initiative cause us to lose focus on our domestic market growth – or can we realistically tackle both at the same time?

- Does the international initiative have the potential to be more profitable than further domestic expansion?

- Using our internal resources, will we be able to provide adequate levels of support to new international franchisees all while maintaining support for our current domestic franchisees?

- If the answer to the question above is “maybe” or perhaps even “no,” when and how will we be able to set up additional (likely international) offices to provide the support needed?

- Do we need to engage individuals with experience in international franchising to assist with strategic planning and support?

- Are there external factors (competitive actions, developments in international markets, opportunities to partner with significant international players, etc.) that we should consider when deciding to go international now rather than later?

- Are there other benefits associated with going international that make this an immediate priority?

2. Are the resources available?

Launching an international franchise effort requires a substantial financial commitment. Travel, legal costs, and market research only make up a portion of the expenses a franchisor can expect to incur.

The tasks of finding the right local partner and conducting due diligence take time and money if they are to be done correctly. Frequent market visits are essential, as they provide insight on a brand’s potential viability, consumer preferences and expectations, existing competition, real estate considerations, and the potential concept adaptations that may be required in entering a new market. Secondary market research should only act as a supplement to the first-hand knowledge that a franchisor gathers on foreign soil.

All told, with trademark protection work, legal research, tax analyses, market research, vendor/supplier diligence, translation and customization, travel, broker’s fees, marketing expense, comprehensive background checks, letters of intent, initial drafts of contracts, and disclosure documents (where required), an investment in an international expansion effort can easily exceed $100,000 USD before any fees are even paid by the initial licensee (and potential commissions are paid) and can often go much higher.

Suffice it to say those headed overseas need to be prepared for the significant costs of doing business internationally before making that commitment.

3. Does the franchisor have the right people?

In addition to capital, the new international franchisor will need to have the people to provide service and support to their new international franchisees. And while the franchisor's initial inclination may be to say that their domestic team can handle international expansion, that route is not without its pitfalls.

First, of course, is the question of resource cannibalization. If human resources are reassigned from their domestic duties to fulfill these new international needs, domestic expansion efforts may well – and often do – take a hit. Moreover, it is important to understand that the domestic team may not be well suited to an international role. International support will often require team members to spend extended periods of time overseas on a regular basis – not all team members are interested and able to commit that that amount of travel. And since international staff will often need to wear more hats than a field support person might wear domestically, the franchisor's current staff may not be up to the task.

In much the same way that the best franchisors plan around support domestically, the new international franchisor should address staffing needs by looking at the specific support services that the franchisee will need to be successful internationally.

Assessing the readiness of a domestic system's infrastructure involves a close examination of every functional area within the company. From the legal and marketing teams to IT and operations, each area's current capabilities must be evaluated, as well as what it would take to realistically extend – and, ultimately, replicate – core skills and processes within an international franchise network. Diversity of expertise, adequate bandwidth, and synergy among the domestic team will increase the likelihood of a smoother transition during the expansion process.

In conducting this analysis, it is also important to recognize that international franchisees may require training and support in areas that domestic franchisees do not. If, for example, there is a need for concept adaptation based on local culture, laws, or economic conditions, the franchisor will need to decide how to ultimately deal with those issues. If the franchisor contemplates a master franchise relationship, the franchisor will need to provide training and assistance in areas such as franchise marketing and support. If the franchise sells or uses products that will be sourced locally, supply chain issues will need to be re-considered. Some markets will require the franchisee to import labor rather than recruit locally. So franchisors will often find that their domestic skill set will need to be supplemented in order to help their international franchisees succeed.

4. Competitive Landscape?

Twenty-five or so years ago, when a U.S.-based franchisor entered a foreign market, chances were that it did not face much competition on the franchise front. In most markets, franchising was a relatively new form of business expansion that was largely the

bastion of U.S. brands. But today, franchisors going abroad face a much more competitive franchise marketplace in almost every country in which they would like to have a presence.

Upon entering a new market, a franchisor will need to compete for the same pool of franchisee prospects as existing systems – both domestic and international. And if the existing systems are native to that market, they will often have some significant advantages, including a better knowledge of local language and customs, a better understanding of the culture, increased access to real estate, and established supply chains that may provide them advantageous pricing. In addition, franchisors native to the foreign market may enjoy arms-length relationships with local design, construction, and marketing firms, which give them the ability to support franchisees locally, promote their "home grown" roots, and avoid the need to adapt to meet the local cultural and legal requirements as non-native franchisors must do. All of these factors give native-franchisors a head start in developing the market. Of course, the franchisor's international licensee may bring some of this to the table, at least in part, leveling the playing field.

The decision to expand globally also should take into consideration whether a concept is prepared to compete with local brands and international franchise giants who already have a foothold in the target market. The savvy franchisor will want to compare and contrast its value proposition with those of the companies with whom it will compete to make an assessment of its likelihood of success. Local brands should not be discounted. Just because you have never heard of it before, do not assume it will not be a worthy competitor in that market. International brokers, consultants, market research firms, and even agencies within the U.S. government can assist franchisors in gathering the information necessary to determine a concept's readiness.

The strength and longevity of an international strategy depends largely upon how the franchisor has prepared. As with any business decision of this magnitude, a great deal of research and self-assessment is required as a first step.

C. CONSIDERATIONS FOR MARKET PRIORITIZATION

With nearly 200 countries in the world, a franchisor will obviously need to focus its expansion efforts if it hopes to succeed internationally. Like domestic franchising, a strategy in which a franchisor attempts to develop in multiple markets that are remote from one another will result in inefficiencies and, accordingly, will be costly and difficult to support. Instead, a franchisor should start by targeting a specific region in which to focus its efforts. The choice of market focus will often dictate strategy – and vice versa.

For example, if a franchisor chooses to focus on markets with a large middle class where franchising has been embraced, the franchisor may find that a master franchise structure will provide the fastest market penetration. This model will have implications for the fee structure (as fees will be split with the master franchisee), the franchisee profile (an entity capable of building a sales organization), and the support provided (in addition to supporting unit operations, the franchisor will need to train the master franchisee to provide franchise marketing, sales, and other franchisor support services). Alternatively,

if a franchisor chooses to enter markets with a barbell distribution of wealth, the franchisor will likely be looking for large area developers who, while easily identified, are simultaneously being courted by large global franchise brands.

To identify appropriate target markets, a franchisor should start by understanding how its brand will fare considering the current social, political, and economic conditions in a particular region. Sufficient investigation in this regard can prepare a franchisor to overcome certain challenges.

Strategically, there are a number of choices to be made for a first-time international franchisor. Does the franchisor want to target the biggest markets, knowing that they may also be the most difficult, or does the franchisor prefer the markets where competition is the least developed? Perhaps the goal is to identify markets where the logistics of support, language, supply chain, and concept adaptations will be the easiest? Regardless of these strategic choices, the savvy franchisor will want to look at a variety of factors in determining market focus.

1. Market Knowledge

Between internal and external investigation, a franchisor should commit to gaining the clearest possible perspective about potential market opportunities before an international expansion strategy can take shape. Part of that knowledge involves gaining an understanding of the franchise “climate” in a particular country (e.g., the franchisee’s ability to subfranchise, recognition by the legal system, regulatory requirements, the general feelings toward franchising, size of the middle class, degree to which other franchisors have been successful in the market, etc.).

One good source for information on franchising in various international markets comes from the U.S. Commercial Service, which also offers customized research for individual franchisors through their Gold Key Matching Service, as discussed below in Section 2(b)(ii). In addition, the International Franchise Association provides market-specific information at: https://www.franchise.org/international-franchise-opportunities.

(a) Efficiency of Support for Franchisees

The efficiency of providing support to international franchisees is often a complex issue. Factors that will influence support needs and costs include the structure of the franchise offer (area development, master franchise, or direct franchising), complexity of the business, the relative strength and resources of the franchisee, as well as factors such as language, legal differences, consumer differences, geographic proximity, and supply chain. Prior to expanding abroad, a franchisor should first develop a comprehensive business plan that will cover these issues as well as a plan for staffing the support organization.

(b) Socio-Cultural Differences

In order for a franchise concept to succeed in a new market, a franchisor must give thought to adaptability. Just because a franchise system performs well domestically does

not necessarily mean that consumers abroad will respond to it in a similar way. A franchisor looking abroad must consider socio-cultural differences between its domestic market and the international market. Factors such as language, reception of trademarks or logos, local/regional customs, impact of local laws (mandated benefits or vacation time in some countries, or the need to import labor), tastes and preferences, and even religious beliefs (dietary or alcohol restrictions, segregation of sexes in some Muslim markets, need to plan around religious holidays or prayer time, etc.) tend to dictate how target consumers will receive the brand. Thus, a solid understanding of local ideologies and expectations can help a franchisor tailor its concept to a particular market. Foreseeable modifications might include altering certain product offerings to suit local tastes, altering the labor model, changing sources of supply, and/or adapting consumer marketing.

(c) Forecasting Potential Profitability

Once a franchisor has a good idea of how its franchise concept may need to be adapted, it should develop a financial feasibility model to determine whether the model is likely to be profitable enough to create a “win-win” for the franchisee and the franchisor. That said, it would be a mistake for the franchisor to rely exclusively on population and other relevant demographics affecting domestic market potential and doing a side-by-side comparison to draw conclusions.

The primary focus of this financial model should account for differences in the unit economics in the following areas:

- Development and real estate costs (What are land costs, key money, costs of construction, costs of equipment, differences in rent costs that would impact target locations, average rent costs for the target location, etc.?)

- Consumer buying power and local competition (Are there enough consumers who can afford the product/service and, if so, will they be drawn to existing competitors that offer substitute products at substantially lower prices? How will that impact the franchisee’s consumer pricing? How fragmented is the local market? If there are dominant players in the market, how will the franchisor differentiate itself and its products/services from established brands?)

- Costs of goods sold (What is the cost to get key goods into a country? Are current or substitute products readily available through the local supply chain? At similar costs? Will tariffs be imposed on imported products? How will exchange rates affect costs? Are there any restrictions on imports? How will consumer pricing strategies impact cost of goods sold (COGS)?)

- Costs of labor (Is qualified labor readily available and, if so, at what cost? Do local customs or laws dictate different labor practices?)

- Exporting goods from the international partner to the U.S. and other countries is a consideration for product-based franchisors.

One important step in the research of any market is called the "market basket" approach, in which the franchisor or its prospective franchisee would "shop" for a pre-determined basket of goods or services in competitive locations in the target market. By comparing the prices charged for substitute products in the market, the franchisor will gain significant insight as to unit economics in the competitive environment.

(d) Power, Politics, and Economy

A keen eye for the external factors that are shaping the current business climate in a country can be critical to forecasting a franchisor's success abroad. A country's governmental structure, expressions of autonomy, respect for the rule of law, political history, and health of its economy can be indicative of its overall stability.

If a franchisor intends to export product to local franchisees, it is particularly important to understand the impact that variances in exchange rates might have on the franchisee's profitability. In such a situation, a currency devaluation could have a substantial impact on a franchisee's cost of goods sold, impacting either franchisee profitability (if local prices remain constant) or royalties (if they do not). Historically, one resource was the Ease of Doing Business Ranking published by the World Bank Group, but in September 2021, the decision was made to discontinue the Doing Business report and the World Bank Group is working on a new tool assess a country's business environment. More information can be found at ww.doingbusiness.org.

(e) Legal Climate

Considering the amount of time and resources an international expansion plan demands, it is in a franchisor's best interest to investigate the legal regime of the target market. Every franchisor should ask itself: What legislation is currently impacting the local business environment? In addition to franchise-specific laws, the franchisor will need to be cognizant of laws relating to anti-trust, tying, anti-competitive measures, protection of trademarks and intellectual property, employment, enforceability of in-term and post-term non-competition clauses, repatriation of profits, import restrictions, taxation, and other relevant laws.

2. Franchisee Recruiting

Outlining the characteristics of a qualified international franchisee is perhaps even more important to the process than identifying the territory itself. Although potential owner-operators will have varying backgrounds and experience, a franchisor can identify certain core criteria to narrow the prospective franchisee pool and screen out those who lack the ability to succeed in this complex business relationship.

(a) Qualifying Franchisees

(i) Net Worth and Financial Strength

Franchisors typically establish a net worth requirement as a means of sifting through prospective franchisees that might not be able to fund an investment in the

franchise adequately. In the case of international franchising, it is even more important to ensure that those chosen to partner with a franchisor have sufficient financial resources in order to contribute to system-wide stability. Such parameters need to be established based on local market development costs, the availability of credit, and the number of locations that the franchisee will be required to develop – as well as how many of those locations will be owned and/or operated by the prospective franchisee (as opposed to subfranchised locations).

(ii) Willingness to Champion the Brand

Franchisees in a new market should share the franchisor's goals and values and express a commitment to the franchise concept's growth and stability. In essence, these franchisees are forming a foundation for the future of the brand's international presence. As the franchisor determines the appropriate level of franchisee support to provide in a new jurisdiction, the commitment of franchisees that believe in the franchisor's overall mission is incredibly valuable.

The franchisor must make a difficult determination when engaging with large, multi-concept franchisees committing to develop an entire region. The allure of partnering with an established franchisee may be significant; however, there are downsides as well. These franchisees often have much more clout in the marketplace, which empowers them to dictate fees (or refuse to pay initial fees entirely), development strategies, and often changes in operating standards (such as POS systems). Although they will likely be much more adept at concept adaptation, they will be equally likely to cut their losses quickly if a concept does not perform to expectations. Moreover, a franchisor should be prepared to make a sober assessment of whether a multi-concept franchisee will be able to dedicate the necessary resources and management focus to its brand (as compared to the other brands in the franchisee's portfolio) to a sufficient degree that it will be a long-term and reliable brand custodian. Similarly, the franchisor should seek assurances – both at the outset and during the relationship – and even consider mandating in the franchise agreement that a multi-concept franchisee's key management personnel do not rotate among its various brands in a manner that compromises confidentiality obligations. A franchisor that deals with one of these large, multi-concept franchisees must understand who will be charged with the development of its brand and the level of commitment that is being made to development.

It also is important to note that such considerations become multi-dimensional in the context of a master franchise relationship. An effective master franchisee has to be both a solid custodian of the brand and operator of the franchisor's concept in its own right, as well as an effective marketer of its own subfranchises. Importantly, a franchisor should not assume that, just because a would-be master franchisee demonstrates promise in one of these areas, it will be successful in both. International franchising is replete with tales of master franchisees who were solid operators but had toxic relationships with their subfranchisees (to the detriment of the brand) or who, alternatively, were very successful at selling subfranchises (and collecting the associated fees) but complete failures as operators in their own right.

(iii) Business Acumen

One of the biggest advantages of international franchising is that, if all goes well, the franchisee will drive expansion without substantially depleting the franchisor's corporate resources. With this in mind, savvy franchisors will seek prospective franchisees that have the relationships necessary for navigating the local business landscape. Depending on the concept and the growth strategy, these needs may include real estate, construction, marketing, franchise sales, and/or distribution, as well as industry-specific expertise.

Although this approach may favor larger franchisees, numerous brands have had substantial success by finding franchisees that will "grow their own" teams. With such a candidate, the franchisor should focus on management expertise and a track record of developing a team, as well as factoring the need for these hires into the financial qualifications imposed on the candidate.

(iv) Sound Vision for Developing Concept in Target Jurisdiction

At the same time, franchisors will want to ensure that the candidate has a realistic plan for the development of the franchise concept. Every franchisor should, as a part of its vetting process, require each candidate for a market to prepare a detailed business plan that will discuss issues such as prototype development and adaptation, real estate and construction (if applicable), business economics, competitors, market, staffing for support, and a plan for growth.

Many franchisors will provide their international prospects with a template or an outline from which to work when developing this business plan in order to ensure that they receive their candidate's input on all of the issues that will ultimately impact its success. Reading these plans with a critical eye will not only provide insight as to market conditions, but it will also allow the franchisor to gauge whether that candidate has realistic expectations and a sound plan for growth, as well as an understanding of the respective roles of the parties. Most importantly, it will provide the franchisor with a deeper understanding of the candidate's commitment to the brand and business and overall resources.

(v) Communication Skills

Obviously, geographic proximity and language can be impediments to easy and efficient communication. Because the franchisor will not likely visit international markets regularly, a franchisor would be well advised to look for candidates that communicate well and with frequency. During the franchise application process, a franchisor should evaluate the degree and quality of communication it receives from the candidate, as their level of commitment at that stage will often set the tone for future interactions.

Assuming that a franchisor does not have foreign language capabilities, it should not be afraid to require that a candidate's owners and key personnel have some level of fluency in English. English is widely considered to be the "language of business," and has been adopted as such by many multinational companies headquartered outside of

English-speaking countries as the official corporate language. By imposing this requirement, a franchisor can engage with candidates who are willing and able to conduct business in a common language in order to ease the cost and delay of interpreters and translation services.

(b) Prospecting for International Leads

After a franchisor has developed a profile for an ideal candidate, the franchisor must consider how it will identify these prospects. The best candidates are generally not those that approach the franchisor but are instead those that are specifically targeted by the franchisor. Successful franchisors create an Avatar based on the characteristics of a successful domestic franchisee and adapt that to its international market(s) and attempt to generate enough candidates so that candidates are knowingly competing against each other for the franchise.

Although not all inclusive, some of the methods for identifying prospective franchisees include the following:

(i) International Franchise Brokers

Perhaps one of the "easiest" methods to identify prospective franchisees is to employ specialized brokers who focus on the franchise space. Generally speaking, these brokers are well-connected in the franchise community, whether globally or regionally. They will often require a franchisor to initiate the process with a market study. The franchisor will then be responsible for paying for local advertising (directed by the broker), monthly fees, travel expenses, and success fees (which may run 20% to 50% or more of the initial license or development fee for the country). Although the use of brokers will eliminate the need for in-house development personnel, it can still be quite costly.

(ii) Governmental Programs

Governmental programs such as the Gold Key Matching Service provide another targeted means of identifying strong candidates. The U.S. Commercial Service, which oversees the program, is charged with international trade promotion by the U.S. Department of Commerce's International Trade Administration. With a presence in over 75 countries, the Gold Key Matching Service program will arrange for a franchisor to have pre-screened appointments in-country with candidates that will fit its recruiting profile and can follow up with those candidates after the franchisor leaves the market. The services rendered by the U.S. Commercial Service are extremely reasonably priced and do not have associated success fees; however, the strength of their franchise expertise varies by market. And, of course, the franchisor will have to invest its time and effort in traveling to specific markets (although there is a video service that is also offered as a part of the program). More information on the program can be found at: https://www.trade.gov/gold-key-service.

(iii) Franchise Trade Missions

Organizations such as the International Franchise Association sponsor trade missions to various markets to promote franchising. Typically, these trade missions, which are co-sponsored by the U.S. Commercial Service, are limited to about a dozen franchisors and will include several countries in a specific region. Franchisors will travel to several countries over the course of a week or two and can expect to spend about $10,000 plus travel related expenses meeting with qualified prospects in each venue. While this can be a productive means of lead generation, the markets targeted each year are limited, as are the number of participants, making it difficult to center a marketing strategy around these events.

(iv) International Franchise Trade Shows

Trade shows provide an open forum for franchised brands to present their concepts before an interested audience of potential buyers. Trade shows take place at venues worldwide, attracting vast numbers of attendees who are often local to the area and open to finding a franchise opportunity that suits them. These shows provide an excellent setting for engaging with active leads, but a franchisor should be aware that not all prospective franchisees who attend these shows are qualified to invest in a franchise. As discussed above in Section C.2, some prospective franchisees will be a better fit for certain franchise opportunities than others, depending on the level of financing and operational sophistication required.

(v) Foreign Franchise and Trade Associations

A franchisor may consult with franchise and trade associations within the target market that are often willing to help assess the viability of the franchisor’s concept and make appropriate introductions. These associations can use franchisor-established criteria, but they are also able to use their firsthand knowledge of the franchisee pool to suggest additional requirements that might be necessary given certain demographics or economic conditions. Ultimately, these associations can serve as a valuable resource for franchisee recruitment, but again, should not be the center of a franchise recruitment strategy.

(vi) Traditional Advertising and/or Public Relations Activities

Of course, a franchisor can also avail itself of traditional methods of lead generation, including web portals, pay-per-click advertising, print advertising in specialized publications, and public relations – all of which can be done with a highly market-focused approach. These methods tend to be somewhat inefficient; however, they can occasionally generate satisfactory results if they are focused on a highly targeted candidate pool. In a larger sense, public relations activities can serve as a valuable complement to more direct lead generation strategies by acting as third-party validation for franchise concepts that are new to the market.

(vii) Franchisor's Domestic and Local Counsel

It also is not unusual for experienced outside counsel, both in the franchisor's home market as well as abroad, to be a valuable resource in facilitating contacts with some or all of the above resources or even direct introductions with prospective franchisees with whom such counsel may have crossed paths in other deals.

3. Due Diligence on Foreign Franchisees

Given the difficulty in unwinding a foreign transaction (and worse, the potential nightmare of associating with the wrong "partner"), it is imperative that a franchisor conducts thorough due diligence on a potential franchisee prior to finalizing the franchise relationship.

(a) Financial Qualifications

Although a prospective franchisee may have represented that it is adequately capitalized to develop and operate the franchise, the franchisor should not take the prospect at its word. A diligent franchisor will investigate the prospect's financials independently, making use of whatever resources are available. These may include audit records, credit reports, bank statements, or other reports that can support a prospect's claims of financial wherewithal. In countries where that information in not readily available, franchisors may engage local resources to assist with the financial diligence. Savvy franchisors will often ask for letters of credit from a prospect to demonstrate his/her/its financial standing.

(b) References, Background and Credit Checks

Unfortunately, the availability of financial information can vary widely from market to market, underscoring the need for background checks on the prospective franchisee, its owners and key personnel. The U.S. Commercial Service is one resource. Franchisors should consider providing prospective franchisees with detailed questionnaires that seek relevant background information concerning the franchisee's finances, reputation, litigation and/or bankruptcy history, criminal records, third-party business and/or government affiliations, professional licenses and even driving records. Separately, the franchisor also should ask for and contact the prospective franchisee's references (including former or existing business partners and/or vendors) and should network with people in the international franchise community to get additional feedback. Lastly, skimming the Internet for any articles can provide some visibility into the candidate's personal and/or professional image.

Aside from the U.S. Commercial Service, there are a number of companies that specialize in screening and evaluating prospective partners and their capacity to professionally, legally, and economically participate in the business relationship franchising requires (e.g., Kroll and TRACE International) and local counsel in some countries also can be very helpful. This in-depth research – including law enforcement checks, review of regulatory and litigation records, search of adverse media and press

statements and more – allows franchisors to make the most informed decision when evaluating prospective franchisees.

(c) In-Person Meetings

It is imperative for a franchisor to meet in person with its candidate and its owners and operations team. Ideally, the parties should hold at least one meeting at the franchisor's headquarters and another in the country in which the expansion is planned. Nothing compares to a face-to-face meeting to determine the degree to which a candidate shares common values and a commitment to the brand.

A candidate unwilling to visit the franchisor at its headquarters speaks to the candidate's commitment to the brand (or lack thereof). On the other hand, if the franchisor is not willing to visit a candidate in the local market, the franchisor should question its own commitment to international franchising.

(d) Validating Ownership Structures

The extra-territorial application of the franchisor's home country law also should be an essential component of a franchisor's due diligence process. The franchisor needs to be careful to vet the candidate's intended ownership structure and personnel in order to verify that the franchisor is permitted even to conduct business with them. See Sections I.2 through I.5 of this paper for additional information. The U.S. Department of Commerce also provides a list of oppositional groups or individuals who have been deemed unfit for business. This list of economic sanctions – called the "List of Parties of Concern" – can be found on the Department of Commerce's website at: https://www.bis.doc.gov/index.php/policy-guidance/lists-of-parties-of-concern.

D. STRUCTURAL MODELS FOR INTERNATIONAL DEVELOPMENT

There are several different franchise development models that a franchisor may consider for international growth. The common international development models used by franchisors are largely the same models franchisors use for domestic expansion, and they include: area development, master franchise, area representative, single unit, multi-unit and joint ventures arrangements. When choosing the right development model for a given region or country, as discussed earlier in this paper, there are several considerations for franchisors to weigh, such as local laws and customs; the desired degree of control over the brand's rollout and execution; the costs of doing business, including travel; cultural and language barriers; and any regulations concerning franchising, commercial agency, and/or intellectual property requirements.

In general, a franchisor must have the ability to invest the funds and resources required to support planned international expansion efforts if it wishes to have greater control over its foreign operations (including "boots on the ground" in the country or region). Conversely, if a franchisor is unwilling or unable to make the significant investment needed for greater control, the franchisor may elect to delegate some of the more "traditional" franchisor responsibilities to one or more third parties. Along with sacrificing a certain degree of control, there are certainly other costs associated with

delegating these responsibilities. The franchisor will have to compensate the third party designee(s) often by sharing the initial fees and royalties payable by franchisees operating in the defined territory. It can also be difficult for the franchisor to control the quality of the products and services since it will be relying on these third party designee(s) to maintain and enforce its brand standards.

There is no one size fits all approach, as franchisors often utilize more than one development model for international expansion depending on a particular deal or region. For example, a franchisor may opt to use the master franchise model if granting development and subfranchising rights to multiple countries in a single region (e.g., the Middle East), the area development model if granting development rights to a single country or region, and a single unit model if a market can support only a single franchised outlet, such as many islands in the Caribbean.

The following is a general description of the most common franchise models used for international expansion as well as the pros and the cons of each model. The following models are presented in the order of the authors' anecdotal understanding of the most common to least common in terms of frequency of use in international franchising.

1. Area Development Model

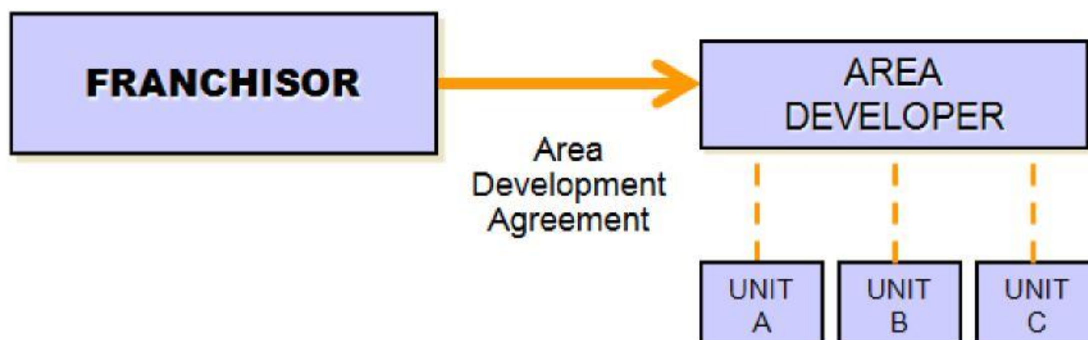
Under an area development model, a franchisor enters into an area development agreement with a third-party franchisee (often referred to as a "developer" or "area developer") whereby the franchisee commits to develop and operate (either itself or through a controlled affiliated entity) a specified number of outlets within a defined territory (which may range from an entire country to a city within the country). An area development agreement often (but not always) grants the developer exclusive rights within the defined territory subject to any rights reserved by the franchisor under the agreement in exchange for the developer adhering to a specific development schedule. Area developers typically pay an area development fee under the area development agreement as consideration for the exclusive territory. Some franchisors make the election to have a portion of this area development fee "credited" against the initial franchise fee for the individual outlets developed pursuant to the development schedule. This expansion model allows the franchisor to retain control over its traditional pre-sale and post-sale support roles by maintaining a direct contractual relationship with the franchisee responsible for the development and operation of each outlet, while at the same time facilitates faster unit growth by not having to solicit a different franchisee for each outlet to be developed in the territory. Unlike the master franchise model (discussed further below), area developers do not have the right to subfranchise; the area developer must develop and operate all of the outlets set forth in the development schedule that is a key commercial term in the area development agreement. However, it is common for area developers to delegate the actual development and operational duties for each outlet developed to an affiliated entity, which then enters into a separate unit franchise agreement with the franchisor for the individual outlet or enters into an affiliate joinder agreement to the area development agreement. Thus, an area development model can at times appear to be a hybrid between the traditional unit franchise model and master

franchise model, but, in the case of the area development model, the franchisor always has a direct contractual relationship with all franchise entities.

The area development model is commonly used by mature franchisors that wish to maintain the maximum amount of control over their brand internationally. The area development model can also serve as a convenient way for a franchisor to take advantage of a local franchisee's knowledge of real estate markets and key connections needed to enable the brand to expand effectively within a new target country or region, which can make the difference between aggressive growth and inconvenient roadblocks. Although an area developer is responsible for the bulk of the development responsibility, the franchisor retains responsibility for providing the franchisor's services under the area development agreement (e.g., site approval, initial and ongoing training, operational support and inspections, and ensuring the franchise offer is compliant with applicable franchise or other regulations within the territory). The contractual relationships under the area development model are illustrated below.

Similar to a development agreement, an international multi-unit franchise agreement (IMUFA) can be used to grant franchisee rights to develop and operate multiple units in one franchise agreement. Many of the legal and business issues applicable to franchising through an area development agreement are identical to those which are considered in the formation of an IMUFA, except that those provisions regarding each outlet operated by the developer (i.e., site selection, operation, franchise fee, royalties, termination, etc.) will be negotiated into the IMUFA and executed up front, instead of in a separate unit franchise agreement that is entered into for each location. While forming an IMUFA involves more negotiation and administration up front as compared to using a traditional development agreement, the IMUFA provides greater administrative ease by avoiding the execution of multiple agreements and thereby avoiding the potentially onerous disclosure obligations associated with same. As such, IMUFAs are typically used for expansion into target countries with burdensome disclosure obligations.

Illustration of Contractual Relationship:



• Franchise Agreement for each unit

AREA DEVELOPMENT	
PROS	**CONS**
- Franchisor retains a high level of control over the brand	- Difficult to find developers with sufficient capital and resources to develop an entire country
- Faster growth and development in a territory (verses single-unit franchising)	- Requires more of franchisor's resources than master franchise and area representative models, including regular monitoring and support by franchisor
- One franchisee operating in a market	- Can tie up an entire market for many years if franchisee has development challenges (including delays due to potential litigation with the franchisee)
- Economies of scale as it can be more profitable for a franchisee to operate more than one franchised business unit	- Developer will incur higher overhead costs due to the organizational infrastructure needed for a multi-unit system
- Requires less of franchisor's resources as the developer gains experience and opens additional franchised outlets	- A poorly performing developer can damage the franchisor's brand in an entire market (and perhaps even outside the designated market)
- Higher initial fee payable to franchisor at times used as a form of "pre-payment" for unit franchises to be developed and territory exclusivity	- Franchisor more likely needs to perform its own due diligence on the territory and its applicable laws and customs
- Easier to terminate than a master franchise relationship because there are no subfranchisees	- Risk of increased liability and exposure to third-party claims due to the direct relationship
- Franchisor need not split initial fees or royalties with a master franchisee or area representative	- Higher expenses incurred in the recruitment and vetting of international franchisee candidates
	- Can be administratively burdensome when using a development agreement if multiple rounds of disclosure are required for each unit franchise agreement

2. Master Franchise Model

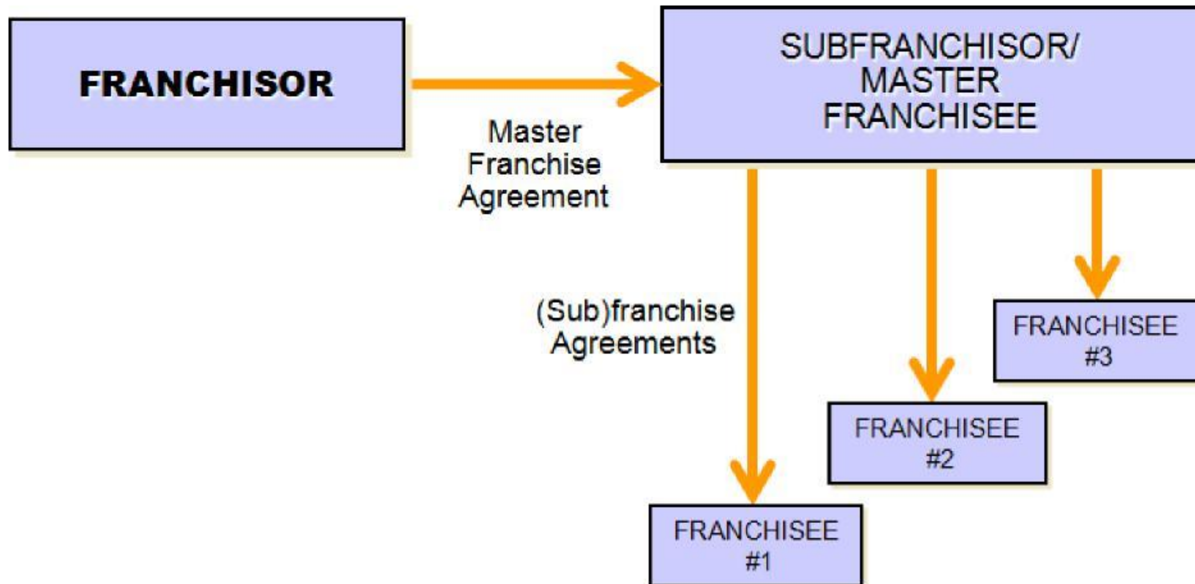
In a master franchise model, the franchisor grants a franchisee (referred to as a "master franchisee") the right to open and operate franchised outlets within a defined

territory as well as the right to grant franchises to other third-parties (often referred as "subfranchisees") to open and operate franchised outlets in the territory. As illustrated below, the distinguishing factor in the master franchise model from the rest of the international expansion models is that the franchisor has no direct contractual relationship with the subfranchisees. Rather, the subfranchisees enter into subfranchise agreements directly with the master franchisee. Short of retaining the right to approve or reject subfranchisee candidates proffered by the master franchisee (which can create potential liability for the master franchisor in certain jurisdictions), specifying the form of subfranchise agreement that the master franchisee must use with its subfranchisees, and reserving the ability to enforce the master franchisee's rights under the subfranchise agreement should the master franchisee fail to do so, the franchisor delegates all franchise activities in the territory to the master franchisee who effectively acts as the franchisor in the territory. Master franchise arrangements are popular in international expansion efforts where the franchisor either is unable or is unwilling to invest the necessary resources to support franchise operations in an international market.

Similar to the area development model, a master franchise agreement typically grants the master franchisee exclusive rights within the defined territory subject to any rights reserved by the franchisor under the agreement in exchange for the master franchisee adhering to a specific development schedule. Unlike the area development model, though, the master franchisee can satisfy the development obligations by developing its own franchised outlets or soliciting subfranchisees to develop the required franchised outlets. Master franchisees typically pay an initial master franchise fee under the master franchise agreement as consideration for the exclusive territory, as well as a portion of the initial franchise fees and royalties (and in some cases a portion of the advertising fees) payable by subfranchisees in the territory. In some instances, the franchisor may require the master franchisee to pay a greater portion of the initial franchise fees or royalties for the outlets developed by the master franchisee or its affiliate entities.

In the typical master franchise model, the master franchisee is obligated to develop and operate at least one franchised outlet in the territory in order to learn the franchise system, get comfortable with operating the franchise, and navigate the logistics of sourcing local suppliers for products and services according to the franchisor's standards. That particular outlet often serves as the flagship store and training center in the territory. The master franchise agreement also requires the master franchisee to monitor subfranchisees' performance and compliance with brand standards through inspections and audits, and provide the franchisor with regular reports on the subfranchisees' performance. Often, the master franchisee is granted the right to adapt or modify the franchisor's brand standards or system requirements to the local laws, business practices, customs and tastes within the territory, subject to the franchisor's approval. The master franchise agreement may include a broad license allowing the master franchisee to offer both single unit and multi-unit franchises as well as area representative franchises; however, the master franchise agreement typically prohibits the granting of additional master franchise agreements by the master franchisee.

Illustration of Contractual Relationship:



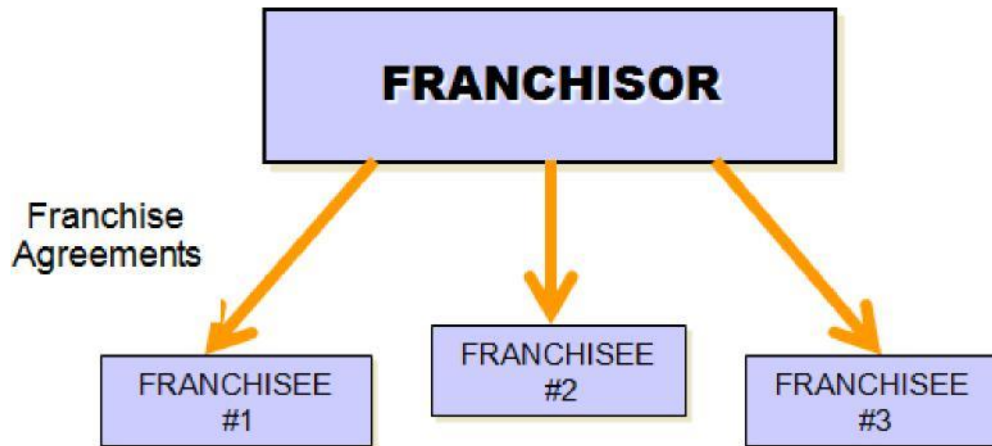
MASTER FRANCHISE	
PROS	**CONS**
- Requires less of franchisor's capital	- Franchisor surrenders substantial day-to-day control over the brand, including privity of contract, to master franchisee who may not share the same passion and commitment as franchisor
- Master franchisee has a presence in the territory	- Can be difficult for franchisor to control quality of products and services since relies on master franchisee to maintain brand standards
- Faster growth and development in a territory and can be used for larger territories (multinational regions or large countries)	- Can tie up an entire market for many years if franchisee has development challenges (including delays due to potential litigation with the franchisee)
- Master franchisee has better understanding of local markets and local competition and is in a better position to adapt the franchise system to the territory	- Same franchisee will not be operating each franchised outlet, which may lead to varying degrees of brand compliance

MASTER FRANCHISE	
PROS	**CONS**
- Requires less of franchisor's resources because master franchisee serves as "franchisor" and supports the subfranchisees in the territory	- Can be difficult to manage and/or terminate the relationship if the master franchisee granted subfranchises in the territory (i.e., franchisor may suddenly be in a position where the franchisor must either service subfranchisees in a territory without appropriate resources or local knowledge or terminate the subfranchise agreements and withdraw from the market)
- Lower risk of liability and exposure to third-party subfranchisee claims as compared to unit franchise model due to lack of direct relationship	- Franchisor makes less money due to the need to split initial fees/royalties and may have little visibility over subfranchisee payments made to master franchisee
- Higher initial fee payable to franchisor for territory exclusivity	- A poorly performing master franchisee can damage the franchisor's brand in an entire market (and perhaps even outside the designated market)
	- In some jurisdictions, the franchisor may be liable to third party subfranchisees for the actions of the master franchisee, depending on the degree of control/decision making retained by the franchisor in respect of the third party subfranchisees

3. Unit Franchise Model

The single unit franchise model in an international context is basically an extension of the typical single unit franchise model utilized by the majority of franchisors in their home market. As illustrated below, the unit franchise model involves a franchisor entering into a franchise agreement with a franchisee for the development and operation of a single franchised business (and there is no grant of territorial exclusivity in the greater region where the unit is located). The franchisor remains obligated to perform the duties of the franchisor under the franchise agreement, such as training, support services, and inspections and quality control. In an international unit franchise model, the franchisor must either have a local presence in the country or region of the unit franchise, or attempt to perform its duties long-distance.

Illustration of Contractual Relationship:



UNIT FRANCHISE	
PROS	**CONS**
- Franchisor retains a high level of control over the brand	- Slower growth and development in the foreign territory
- Franchisee is not highly leveraged since is operating only one franchised outlet	- Requires more of franchisor's resources, including regular monitoring and support by franchisor
- Franchisee is likely the operator of the franchised business with a personal stake in the business	- Lower initial fee payable to franchisor compared to other international franchise models
- Franchisor need not split fees	- Franchisor must perform its own due diligence on the territory and its applicable laws and customs
- Easier to manage and, if needed, terminate the relationship since grant is limited to a single unit	- Risk of increased liability and exposure to third-party claims due to the direct relationship

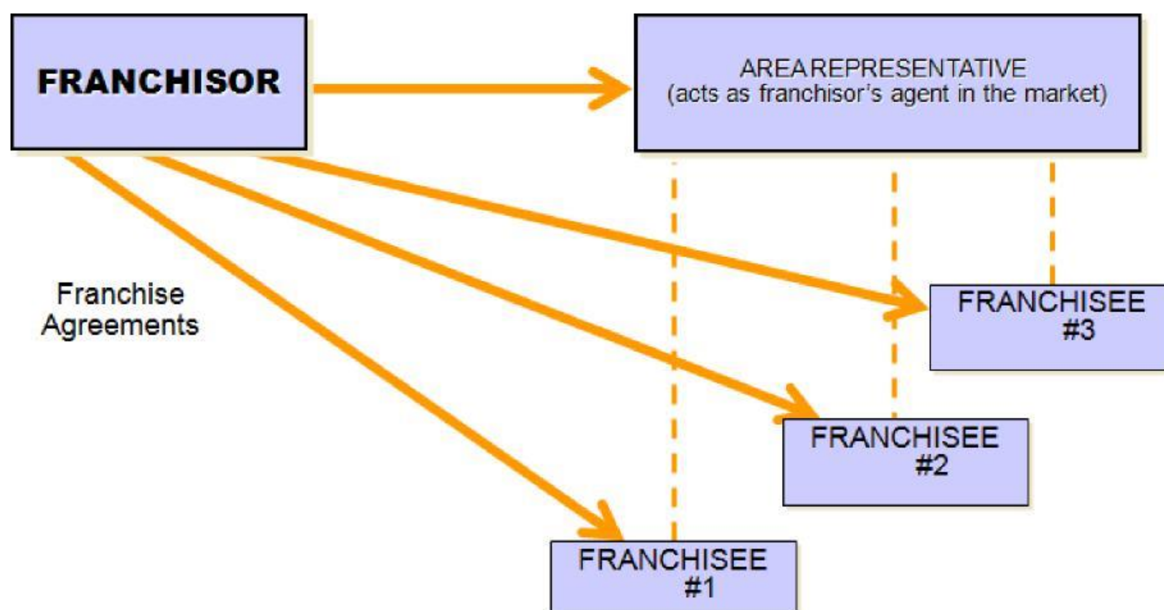
4. Area Representative Model

The area representative model is one of two traditional three-party franchise models. Under an area representative model the franchisor, through an area representative agreement, delegates certain pre-sale and post-sale obligations to the area representative franchisee (often referred to as a "development agent," or "area representative"). The area representative markets franchises and screens prospective franchisees in a defined territory, and in most cases when dealing with an international area representative arrangement, the area representative also assists with the

franchisor's post-sale obligations, such as site selection, construction supervision, training and on-going inspections and support. As illustrated below, in an area representative model, the franchisor will enter into two separate contractual arrangements: an area representative agreement with the area representative, and a unit franchise agreement or area development agreement with the franchisee who plans to develop the franchised outlet(s). No direct contractual relationship exists between the area representative and the unit franchisees.

An area representative acts similar to a franchise broker by soliciting, recruiting and screening prospective franchisees and providing other pre-sale services to the franchisor. An area representative should be obligated under the area representative agreement to comply with all applicable franchise laws in the territory. An area representative agreement typically grants the area representative exclusive rights within the defined territory (subject to any rights reserved by the franchisor under the agreement) in exchange for the area representative adhering to a specific development schedule. The area representative has the option either to solicit third parties to enter into franchise agreements with the franchisor or develop the territory itself by entering into the franchise agreements with the franchisor. In most cases, the area representative pays an initial fee to the franchisor for the area representative rights to the territory (especially if the rights are exclusive), but the area representative is then compensated by receiving a negotiated percentage of the initial franchise fees received by the franchisor from franchisees in the territory. For area representatives who continue to provide ongoing services to franchisees post-sale, the franchisor typically also compensates the area representative with a portion of the ongoing royalty fees collected from franchisees in the territory.

Illustration of Contractual Relationship:



AREA REPRESENTATIVE*	
PROS	CONS
- More control than master franchise model because franchisor enters into franchise agreements directly with franchisees	- Franchisor has less control over franchisee operations (delegates key responsibilities to the area representative), which may result in harm to the brand
- Area representative has a presence in the territory	- Franchisor makes less money because of ongoing royalty and initial franchise fee commissions payable to area representative
- Requires less of franchisor's resources because area representative performs pre- and post-sale services on behalf of franchisor	- Franchisor is liable for acts of its agents; therefore, if an area representative violates franchise registration or disclosure laws, the franchisor can be liable
- Higher initial fee payable to franchisor for ongoing revenue stream and territory exclusivity	- Loss of area representative in a market can be damaging to operations in an entire market and result in the franchisor suddenly being in a position where it must service franchisees in a territory without appropriate resources or local knowledge

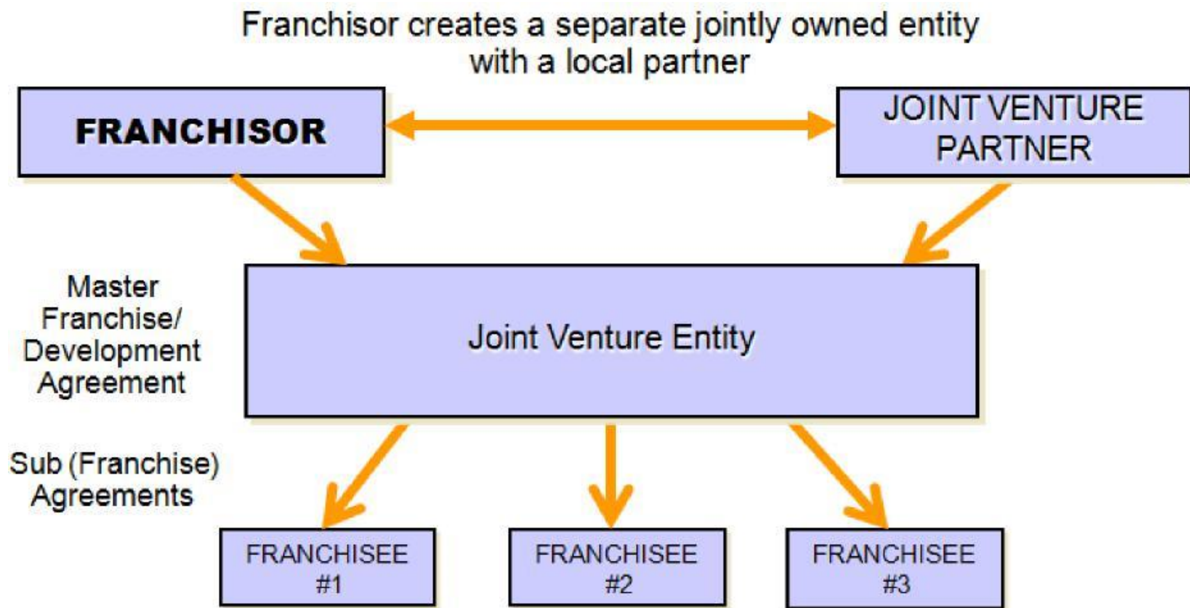
* The pros and cons of the unit franchise model also apply to the area representative model

5. Joint Ventures

The joint venture model is often used where two companies each have something of value to contribute to the relationship beyond money or where the franchisor wants to participate in the potential profits at the franchisee level. The most common structure for the joint venture model is where the brand owner/franchisor and local partner enter into a contractual relationship with one another, usually in the form of an operating agreement (or other form of partnership agreement). The joint venture entity then serves as the local franchisee with the right to develop outlets in a defined territory either directly by the joint venture entity or by granting subfranchises to third party subfranchisees. The contractual relationships under the joint venture model are illustrated below. Franchisors most often require the joint venture franchisee to enter into a franchise agreement with the franchisor under which the franchisor collects initial franchise fees and royalties from the joint venture franchisee. Alternatively, the franchisor can enter into a license agreement with the joint venture entity, whereby the franchisor grants the joint venture entity the right to use the intellectual property associated with the franchise system (including trademarks, operations manuals, and applicable trade dress, recipes, equipment, etc.) within the defined territory. The franchisor may also contribute capital to the joint venture entity in addition to the licensed intellectual property rights; however, most often franchisors prefer to rely on the local partner for the necessary capital. Regardless, the license from

franchisor to joint venture entity will likely qualify as a franchise (or master franchise) in those countries with franchise regulation, thereby triggering certain disclosure obligations, among other requirements.

Illustration of Contractual Relationship:



JOINT VENTURE	
PROS	**CONS**
- Franchisor retains a high level of control over the brand because joint venture will contract with the franchisor or an affiliate	- The joint venture structure and underlying documents can be complex and raise challenging franchise disclosure and corporate law issues, requiring more sophisticated advice and more negotiation than other structures, which can lead to higher legal costs (including retaining local counsel and accountants to advise on local corporate and tax issues)
- Franchisor has a direct role in the development of the territory	- Potential need for capital investment by franchisor, as well as potential investment of other domestic resources and personnel
- Requires less of franchisor's capital to expand	- Risk of increased liability and exposure to third-party claims and applicable laws of the territory, including corporate and tax laws
- Joint venture partner typically has a presence in the territory	- Liquidity pressures of a joint- venture partner seeking an eventual exit event

E. KEY BUSINESS ISSUES/NEGOTIATING THE DEAL

Once you have selected your local franchisee and have determined the structure that you wish to use, the next task is negotiating your agreement. Before diving into the specific contractual terms – many of which are, thankfully, quite similar to the terms negotiated domestically – a note on the influence of culture in contract negotiations is warranted. In general, the process of negotiating an international franchise arrangement is not wholly dissimilar from the process in the United States. The franchisor and potential franchisee may meet in person, in a video conference call, or over the phone to discuss a framework, and, after a series of follow up interactions, marked up documents, and visits, the deal is reached.

For international deals, particularly in emerging markets, it is important to be sensitive to local expectations regarding the negotiation process. Many cultures will favor face-to-face negotiations rather than discussions over phone, video conferences, or email. At each meeting, there is often an unspoken requirement that the parties will engage in pleasantries and personal conversation prior to tackling the issues at hand. Additionally, expectations for communication and negotiation style also vary widely from territory to territory. A good local counsel will be able to guide you through the local protocol to ensure your negotiations are smooth and successful. Moreover, franchisors who can effectively communicate how and why the key provisions of their standard franchise agreement serve the purpose of protecting their brand will greatly improve their chances of bridging the cultural gaps that inevitably will arise in a cross-border negotiation. And, of course, the domestic laws of the target country affecting the formation, interpretation and enforceability of contracts in general must be considered by the franchisor when negotiating the deal.

What follows is a brief introduction of the key business issues to be negotiated in your international deal.

1. Fees

We will begin with fees because, other than the rare scenario where you extend franchise rights to a party for a strategic reason unrelated to generating revenue, fees are the reason you are in business and likely the only means by which to continue in business. Just as with domestic franchises, fees can be broken into a few categories, including upfront fees, unit fees, advertising fees, and royalties. We will address each in turn.

(a) Upfront Fees

Upfront fees are the charges you recover from your franchisee at the outset of your relationship in exchange for granting the franchise. These fees are often collected at the signing of the franchise agreement, or they can be split and/or structured to accompany certain stages of the relationship, beginning with the letter of intent. Formulas for calculation of these fees vary widely. Some franchisors charge flat fees, and others determine the amount based on one or more of the following factors:

- **Size of the territory.** Can the territory support a large number of franchised units? If so, a higher fee may be appropriate.

- **Scope of the local partner's rights in the territory.** Will the local partner develop, own, and/or operate the franchise in the territory? If yes, will the local partner do so exclusively? Will they enjoy master franchise rights enabling them to subfranchise?

- **Market precedents.** How much are similarly positioned competitors charging in the market or region?

- **Local economy.** Is your target upfront fee justifiable in light of the relative strength of the local economy?

- **Franchisee strength.** How does the strength, size, and sophistication of the local party factor into your fee?

- **Nature and extent of franchisor support.** Will you allow the partner to leverage your domestic balance sheet to support payroll or marketing? Will you hire additional headcount either at your headquarters or in-market to help get the business off the ground? Will franchisees have the same access to research, product and service development, and technology updates as your domestic franchisees? Will you need to deploy franchisor personnel to the local market to conduct training and provide additional operational support during the "start-up" phase of the relationship?

- **Nature and extent of franchisor's upfront costs of market entry.** Will the franchisor incur significant legal and other administrative expenses to market its product or service in the target market successfully?

In your negotiation of the upfront fee, your position as a franchisor will likely be that the fee is the local partner's price of admission to the business in the territory. From the perspective of the franchisor, it is as much a symbolic payment as it is a financial one, particularly in light of strict (and ever changing) accounting rules for recognition. A substantial upfront payment also lowers the franchisor's risk, to some extent, that the local partner will default with respect to its obligations to the franchisor over the course of the relationship and ensures that at least some of the franchisor's out-of-pocket expenses associated with market entry are recovered. This is perhaps more important in the international context than in the domestic setting, given the physical distance between the franchisor and its local partner and the extra steps that may be necessary under the foreign legal system to enforce the local partner's obligations in the event of default.

(b) Unit Fees

If your arrangement with the local partner allows the partner to open and operate its own locations, the franchisor will likely charge a fee to compensate itself for the support provided at each location. A franchisor may elect to charge a unit fee comparable or equal

to fees charged domestically in the United States. This is not a bad starting point for your conversations, as it is justifiable to look to the domestic processes when at all possible in negotiating your deal. However, from the local partner's perspective, this amount may not be justified, as the partner will not likely have direct access to the types of support offered to domestic franchisees and/or justifiably may expect the franchisor to make use of its off-the-shelf technology tools (e.g., webinars) to provide such support at a lower cost. To a large extent, the factors to be taken into consideration when determining upfront fees will also impact the amount of the fee to be charged per unit. Upfront fees and unit fees are also linked in that, in some scenarios, the upfront fee charged will be a percentage of the total estimated unit fees. If this is your approach, you are well-advised to consult with your US accounting advisors to determine whether and when such advance fees can be recognized.

(c) Advertising Contribution

The requirement to set aside a portion of net sales for advertising is common to both international and domestic franchise businesses, and the negotiation of that amount will likely proceed similarly in either circumstance. One key difference between the domestic and international appeal of a franchise is in the extent to which the franchisor has established a clear brand identity and defined the consumer proposition. A typical franchisee will be attracted to a franchise opportunity because they view the business as "turnkey."— In other words, franchisees are able to take advantage of the solid platform the franchisor has established and can begin to attract customers nearly from their first day of business due to the franchisor's investment in a consumer base.

By contrast, the international franchise owner often will not have the benefit of a ready-made market. Often, international franchisees find they need to invest far more than the proposed advertising rate to educate the public and drive sales sufficiently. Therefore, the modern international franchise partner may look to the franchisor to bear some of the burden of the marketing expense for a period of time. If agreed in concept, this can be structured in a number of ways. The parties may consider direct payments, reimbursements of expenses, or even the establishment of a fund into which the franchisee and franchisor jointly contribute and which can be expanded to benefit any additional franchisees established in the market (discussed further below). Finally, well-established franchisors also should be prepared to assist the franchisee with the development of marketing materials for use in the local market, perhaps by making its "asset library" of marketing materials available. However, translation into the local language and local cultural norms and expectations must be considered. Thus, a franchisor must balance its interest in maintaining a consistent brand and advertising voice in its total operating territory, while taking advantage of the franchisee's better knowledge of local language, customs and culture.

Many franchisors provide for and control pooled or cooperative advertising funds. When expanding internationally, a franchisor must consider how much its international franchisees should spend on local advertising, and whether it will require its international franchisees to contribute to such a pooled advertising fund, or if it will set up a separate regional fund. If pooled contributions are required, the franchisor must decide whether it

will actually spend any money from the fund internationally and whether it should reserve the right to spend some of the fund contributions on domestic advertising.

(d) Royalty

Like other financial terms, you will likely find negotiation of the royalty rate to be a more rigorous process in international deals than it is in domestic deals. In particular, the lack of a critical mass of franchise businesses in emerging markets means your partner will likely not be familiar with the standard rates charged. Consequently, you should be prepared to explain – and justify – the amounts you request. In addition, while the concept of a royalty in some markets is well understood, you may have partners in other markets who do not believe in paying a royalty for the use of your trademark. If this is the starting point of the conversation with your potential partner, you may need to look elsewhere for a better relationship fit.

It also is important to remember that the royalty structure is likely to vary depending on the franchisor's preferred development model. For example, with respect to the master franchise model, a key subject of negotiation will involve the allocation of royalties paid by subfranchisees. Similar negotiations should be expected when pursuing a joint venture model.

When setting the royalty rate (and other fees), you should consider that the initial and ongoing costs to support an international program may be much higher than a domestic program (i.e., on-site visitation costs will be higher, operational support may be more complicated and therefore more costly, etc.) and there may be additional expenses that have no corollary in your domestic program (i.e., legal counsel costs, translation costs for agreement and materials, additional taxes, etc). Therefore, you must consider whether you will bear these increased costs or if some of these costs will be passed on to the franchisees in the form of a higher royalty rate or other increased fees.

2. Scope of Territory/Exclusivity

Depending on your long-term outlook and plan for market development, you will need to determine the size of the market to be granted to your franchisee. Franchisors should have general familiarity with the cultural differences, language differences, and demographic changes within the geographic regions in which they are expanding, and local embassies, local counsel, and individual franchisee prospects can all provide key information in this regard. Franchisees will likely negotiate for exclusivity throughout the country. This obviously gives them the security of operating free from competition and allows them to develop a comprehensive strategy of their own for the build-out of the entire country. They may also argue that supply chain issues arise when additional groups are allowed to develop, own, or operate in the same market, and the surest way to mitigate these is to have a single partner in the country. In a post-COVID 19 era when supply chains are particularly vulnerable, this consideration is likely to be top of mind for prospective partners. Additionally, they will likely make the point that a single partner in the country streamlines your administration and support as you will have a single contact in the market to manage long term.

While these are all valid points, a franchisor is well-advised to refrain from granting rights (exclusive or otherwise) in and to an entire country from day one of your relationship. This is especially true in major markets such as China and India. Except in the case of a well-established partner with a wealth of successful experience in your industry and in the country, most local partners will find the learning curve steeper than expected and the path to profit longer than anticipated. They may seek to try out different trade areas in the country, bouncing from one to another when their early efforts at an initial trade area were unfruitful. They may slow down on development, or worse, cease to develop altogether while they reset their efforts at refining the business model. While franchisors should be sympathetic and supportive of the experience of partners breaking into the market, franchisors should not have to suffer the lost opportunity cost incurred by stalled development or false starts. Just as a sound investor may diversify its investment portfolio, a smart franchisor should consider structuring a deal that allows for additional local partners to participate in expanding the brand. Instead of an all at once approach, a staggered grant of pieces of the territory – whether key cities or key trade areas within a city, for example – contingent upon the local partner's meeting key milestones may give the partner a meaningful carrot to work towards. Such an approach may also help to focus the partner on successfully building out the country step by step instead of a buckshot approach. As noted above under our discussion of fees, any grant of exclusivity should be reciprocated by a payment of an appropriate fee. If a franchisee will be assigned a territory that spans multiple regions, languages, or countries, you should be assured that they have the experience and connections required to be successful in each area.

Most franchisors also are well-advised to consider potential alternative distribution models in the local market and whether they wish to reserve such rights to themselves separately and distinct from the contemplated franchisee relationship. Such rights, which can vary from internet sales to the operation of stores in non-traditional locations (such as airports, hospitals, military bases, and college campuses) should be clearly reserved to the franchisor in the franchise agreement.

3. Transfer Restrictions

As discussed, beyond any cultural or language gaps you may need to bridge with your international partner, a central challenge of franchising internationally is the physical distance between you and your local partner. This is a principal reason why you and your local partner should take seriously the negotiation of transfer restrictions. To be sure, franchise rights should be personal and non-transferrable, except with consent of the franchisor. The franchisor should have the ability to review any individual or entity that might become a part of their system, both for protection of the brand and for the protection of all franchisees, domestic and international. From the outset, it is important to establish a meaningful level of trust and healthy rapport with your local partner. This, almost more than anything in the agreement, will help you ensure that the business stays in the hands of this partner rather than being transferred without your knowledge.

Franchisees will propose lenient transfer rules, allowing them to transfer to others freely or with post-transfer notice to the franchisor. Franchisors should insist that no transfers be made without their consent and require in the agreement that any requests

for consent be accompanied by sufficient information to enable the franchisor to make an informed decision as to whether accept the proposed transferee. You may relax the rules for a select class of "permitted transferees," including wholly owned subsidiaries or for transfers of de minimis ownership rights in the partner. In the case of these transfers, you should require advance notice of the proposed transfer and condition the right on clearance of the proposed transferee by your internal risk team. Your local and U.S. counsel can assist in determining the appropriate restrictions on publicly-held franchisees.

You should not negotiate your right to require the franchisee to secure your prior written consent with respect to any proposed transfer and the transfer conditions with which the transferee and transferee must comply to minimize potential risk to the brand. Such conditions typically might require that, in connection with the transfer: (i) the transferee signs the franchisor's then-current form of franchise agreement, (ii) the transferor and/or transferee pay a transfer fee to offset any costs incurred by the franchisor (e.g., legal and administrative expenses such as due diligence costs) in connection with the transfer; (iii) store locations be renovated or upgraded to comply with brand standards.; (iv) all of transferor's accrued monetary obligations and all other outstanding obligations to franchisor and its affiliates have been satisfied; (v) where permissible, transferor signs a general release of any and all claims against franchisor and its affiliates, and their respective officers, directors, agents, shareholders, and employees; (vi) transferor remains liable for all of the obligations to franchisor in connection with the franchise business that arose prior to the effective date of the transfer and execute any and all instruments reasonably requested by franchisor to evidence such liability, (vii) transferee completes the training program required by franchisor; and (viii) transferor is not in default of any provision of the franchise agreement or any other agreement between transferor and franchisor or its affiliates.

4. Termination Rights

Just as you will want to draft tight transfer restrictions to prevent the rights of your brand from falling into unapproved hands, you will similarly want to ensure you have broad termination rights. When negotiating termination rights, franchisors should bear in mind that terminating an international franchise can be painful and costly, as the franchisor may be forced to enter a region to service the franchise system, enforce post-termination provisions, and to verify that the former franchisee is no longer operating under the system or using the marks. Further, franchisors should consider the local laws in the targeted international jurisdiction in respect of any duties the franchisor may owe to the franchisee, and how these duties may be exercised in the context of a termination. For example, if the duty of good faith and fair dealing applies to the franchisor-franchisee relationship, the franchisor will want to ensure more specific and stringent events of default and termination requirements are clearly set out in the franchise agreement in order to avoid or protect itself in any disputes where a franchisee may allege the franchisor did not comply with any such duty. As in the case of domestic franchises, it is advisable that franchisors lay out at least three different types of terminations in their agreements.

(a) Automatic Termination

There are a number of reasons you may want your agreement to provide for automatic termination. For example, if you have allowed the franchisee to use as collateral shares of the franchise entity or assets of its business, (a step which is itself not in your best interest without a separate agreement clarifying your rights and the rights of the lender), you may wish to have your agreement terminate in the event of lender foreclosure. This is advisable for domestic agreements as well, but, in the case of international agreements, it is particularly advisable because it is harder to monitor your international franchisees and learn of foreclosures than it is with domestic partners. Providing for automatic termination with no further action gives you the benefit of preventing banks or other financial institutions from stepping in to run the franchise. This is of particular importance because such institutions often do not share the same business motivations as the franchisor. However, you must be aware that, in certain jurisdictions, provisions triggering automatic termination of the franchise agreement in the event of franchisee's bankruptcy or any similar proceeding are unenforceable.

In the context of an international franchise relationship, most franchisors must also consider certain geopolitical realities when contemplating when automatic termination would be appropriate. This is especially true in emerging and politically volatile markets. For example, a lockdown on cross-border currency remittances or oppressive visa restrictions (preventing the franchisor's employees from inspecting the franchisee's operations) that last longer than a franchisor would be willing to accept might present scenarios where the franchisor would want to automatically terminate the franchise agreement.

(b) Termination on Notice

Termination on notice allows you to end the franchise relationship with a few days' notice. You may, however, wish to afford the partner the opportunity to cure the default that triggered the notice, but, often, they are the types of breaches that simply cannot be cured. These include transfers without consent, breaches of confidentiality, submission of misleading books and records, and violations of anti-corruption/anti-money-laundering laws and other criminal activity.

(c) Default and Termination with a Right to Cure

Providing the franchisee a right to cure a default of the franchise agreement is reserved for general breaches of the agreement and may include repetitive late payments of fees, failure to adhere to an agreed development schedule, and any other curable breach of the agreement.

As with all aspects of the negotiation, you will need to coordinate with local counsel to make sure these termination categories and rights are enforceable since, as is the case with certain U.S. states, many foreign jurisdictions have relationship laws that allow for termination only with good cause and/or afford the franchisee the opportunity to cure the default. In certain jurisdictions, the franchisor's contractual right to terminate the

agreement will be subject to the duty of good faith and fair dealing. Further, local counsel will be able to provide guidance on your rights upon termination and the degree to which you are able to include such rights as enforceable franchisee obligations in the franchise agreement.

At minimum, whether domestic or international, you should have the right on termination to compel the partner to remove all signage bearing your brand's name or trademarks. You may also want the right to purchase any assets of the business, including real estate, after termination. You also should expect the franchisee to (i) return any and all operating manuals, marketing materials, and other documentation that you provided in connection with the franchise; (ii) maintain the confidentiality of the franchisor's proprietary information and trade secrets; (iii) assign its ownership of any trademarks, web domains, and other intellectual property to the franchisor and (iv) execute a termination agreement, preferably one that includes a release of all claims against the franchisor.

In certain jurisdictions, there are a number of housekeeping tasks that must be completed in order to ensure you are protected post-termination. There are territories that require local partners to register their relationship with the franchisor and the franchise agreement with a government agency. Others may require registration of the agreement itself in connection with recognition of the franchisee's rights to use your intellectual property. In either case, you will need to coordinate with local counsel to cancel or transfer any registrations so there is no confusion as to your relationship status with the partner. In some cases, you may require the cooperation of the local partner, so you should try to maintain as amicable a split as possible.

5. Noncompetition Covenant

In your partner selection process, you no doubt will have sought out partners with the level of resources and business acumen that suggests they will be successful in the enterprise. The good news is, if you are targeting emerging markets, you are more likely to find a partner with the financial resources necessary to handle a franchise. Your potential partners may also be more enthusiastic, energetic, creative and have a long¬term view of the business, given the youthful demographic of the emerging market partner pool. Still, and particularly in emerging markets, you may find it more difficult to find a partner that has the type of experience that you may typically require of a domestic partner. The obvious concern any franchisor will have in a situation like this is how to prevent your franchisee from taking all the skills and know-how shared with them over the course of the relationship and applying it to support or grow a rival brand. For this reason, a franchisor should include strict non-competition language in their agreement. The enforceability of noncompetition covenants varies by jurisdiction, and franchisors should consult with local counsel to ensure any such covenants would be enforceable in the event they are brought before a court. Generally speaking, noncompetition covenants should be reasonable both as between the parties and in reference to the public interest. When considering reasonableness, a non-competition covenant must protect a proprietary interest of the franchisor, such as the goodwill of the business, and must not be broader in geographical area, time period or scope of the activities covered than is

necessary to protect such interests effectively and should be clear in their scope and duration. As such, Generally, there are five key points to think about in the drafting of noncompetition covenants: the definition of competing business, the scope of the limitation during the term of the agreement, the scope of the limitation post-termination, the duration of the limitation, and consequences for breach.

(a) Defining "Competing Business"

The definition of "Competing Business" goes toward the particular proprietary interests the franchisor is seeking to protect. In a truly emerging market with minimal competing businesses, you will have the luxury of drafting this language more broadly, as your franchise partner will not likely have available a host of other businesses in which to engage. Further, the franchisor may have a broader proprietary interest, given the lack of similar businesses. By contrast, in more saturated markets where competition is tight, you will likely face push back from franchisees who have interests in other businesses and seek to narrowly define what constitutes competition for your brand, and the truly proprietary aspects of your business may be more limited. In either event, it is important for you to be well educated about the market before you propose your definition. Understanding the competitive landscape – the number and reach of your competitors as well as the products they offer – will help you determine the types of businesses that pose a threat, may become a threat as your brand takes shape in the market, or pose a minimal threat to your business.,

(b) Scope of Noncompetition during the Agreement

Once you have defined what constitutes a competing business, you will need to determine the scope of the noncompetition covenant. Do you want to limit the restrictions to the individual/entity that is your franchisee? Perhaps you want to include all owners and operators of the business? A wider net would include key employees of the business. In addition to the group to which the noncompetition agreement applies, what sorts of activities will trigger your noncompetition restrictions? The obvious answer is that the partner should be prohibited from developing or operating a competing business. But the definitions and limitations get hazy when you consider the myriad ways in which an individual or entity could potentially contribute to a business. For example, would your partner offering guidance to a friend who is starting a competing business constitute a breach of the noncompetition covenant? Or again, if the partner has an interest in a bank and that bank issues a loan to a competing brand, would you consider that a threat to your business? Ultimately, therefore, the scope of your noncompetition agreement will be heavily dependent on the nature of your business and the partner, as well as your particular views on where the line should be drawn between permissible and prohibited activities. You may find that these questions are more complicated in the international context, given the likelihood that your partner is an individual or entity with a wide variety of business experiences, past and continuing, and a network of connected friends and family that may be in direct competition with your brand.

(c) Scope of Post-Term Noncompetition Covenant

You will likely want a noncompetition provision that covers activities of the franchisee after the agreement is terminated. In general, as with domestic noncompetition agreements, limitations must be narrowly drafted to avoid being overly restrictive. You may find a noncompetition agreement that applies to the entire territory, depending on your definition of competing business and the individuals to which it applies, is unenforceable under local law. In that event, depending on the jurisdiction, you may risk having the entire provision invalidated by a court. In businesses that are heavily dependent on real estate and located in jurisdictions where real estate opportunities are tight, a broad noncompetition provision can prevent your former partner from flipping your locations into the hands of competitors, which itself could do damage to your brand image and make growing your brand a challenge.

(d) Duration of Post-term Noncompetition Covenant

Some jurisdictions will require a noncompetition covenant to clearly set forth a reasonable timeframe during which the restrictions apply in order to be enforceable. Generally speaking, restrictive covenants should be conservatively drafted, and a perpetual noncompetitive covenant is not likely to be enforceable. What is considered reasonable will depend on many of the considerations set forth above.

6. Development Schedule

From the perspective of a franchisor, that derives its revenue primarily from royalties paid by franchisees and is not engaged either alone or in partnership with a franchisee in operations, royalties are the life blood of the enterprise. Therefore, franchisors often believe it is in their best interest to require their franchisees to develop quickly. A larger number of units, of course, generates higher net sales and, consequently, higher royalties. However, an overly aggressive development schedule can do more harm than good as strict adherence may force franchisees to open units in unfavorable locations. The task of addressing and renegotiating missed targets is a burdensome distraction to franchisor and franchisee alike. In addition, as with any business, there is a learning curve that your local partner will have to tackle, and, in the process of doing so, your partner may realize that the previously agreed upon targets are simply impossible. Rather than set your partner up for failure, and yourself up for missed revenue targets, it is a good idea to negotiate general goals. You and your local partner should agree early in the process on the number of units that are achievable in the particular market. Consider using that initial conversation as a guide and crafting a reasonable schedule, with or without specific numerical targets, on which both you and your partner can agree. Moreover, it also can be a good idea to consider how best to incentivize the franchisee to manage its market development, perhaps through the use of reduced royalties or fees for each unit that developed and opened in advance of the applicable deadline.

It is also important to negotiate and contract for the types of consequences your partner will face for failure to meet the schedule, particularly if the schedule is reasonable.

Is your brand so desirable that you have a ready back-up partner in the event your partner defaults? If so, you may consider making failure to meet the targets an event of default, the penalty for which is either (a) loss of exclusivity in the market, assuming the partner had such right, or (b) loss of development rights. You may use the lever of an uptick in royalty rates for the period of default, or the right to immediate repayment of any financial obligations owed by the partner to you. There is no one formula or method to achieve the goal of jumpstarting stagnant development – whether with this partner or another – and your lawyer should be able to counsel you regarding development schedule terms that reflect the commercial realities of the local market.

7. Other Points

(a) Taxes

Your international franchise agreement will need to address issues of tax treatment and responsibility. For this reason, it is critical to consult with tax advisors – both domestic and local to the jurisdiction in question – to determine what liabilities you may have in the arrangement and what portion of that responsibility may be appropriate for your local partner to share. Such considerations should be an important first step in any franchisor's financial analysis of a particular market's viability for the sale of its products or services. More specifically, issues such as whether (i) the target market has a tax treaty with the United States, (ii) a withholding tax is imposed on royalties and other fees in the target market (and if so, at what rate) and/or (iii) the target market imposes other quasi-taxes (such as a stamp tax) are likely to be featured in any such analysis. Your tax advisors and attorneys will also be able to tell you the types of filings and other documentation necessary for you to complete and assist in processing those documents.

(b) Supply Chain

It is absolutely imperative that you as franchisor research and fully understand the local supply chain required for your local partner's success, particularly in a post-COVID-19 era when supply chains are particularly vulnerable and volatile. Holes in your partner's supply chain lead to product shortages, the inability to provide necessary services, and ultimately, a failed business. In addition, given the distance between your home office and your local partner, you often will not find out about supply chain issues until it is too late. Local partners may attempt to find solutions for missing components with unapproved or lower quality products without your knowledge. The result is potentially brand damaging, and, with the rise of social media and travel, damage done to your brand in one country may impact your entire system, including in the United States. In addition to making the right supplier choices, making the right logistic choices is also critically important for franchisors and franchisees. The recent disruption of several supply chains in the quick service restaurant industry following the onset of the COVID-19 pandemic demonstrated the importance of having a dynamic, flexible and resilient supply chain to ensure the success of your franchised business.

Understanding the legal parameters impacting the supply chain in the local jurisdiction is also important. Competition and antitrust laws may limit a franchisor's ability

to regulate or control the purchase of products and supplies. This concept is covered in greater detail in Section H (Other Local laws) of this paper.

Once you understand the supply chain – and any legal parameters impacting it – you can and should help your potential partner assemble the pieces to create a full network. Again, it is imperative that this work be done in concert with your partner before any contracts are signed. If you and your partner determine that a critical product simply cannot be sourced, either due to legal restrictions or lack of quality vendors, you may need to reconsider your entrance into the market. In addition, the collaborative work of assembling a supply chain in advance of the agreement helps you to define your particular quality standards. You will be able to preapprove suppliers and have peace of mind that the offerings in the local jurisdiction are on par with what you offer in the United States. Additional contract points on supply chain include, subject to local counsel's guidance, (i) the franchisor's retention of a contractual approval right over new suppliers or new products/services offered by the local partner to ensure compliance with franchisor's standards throughout the relationship; (ii) clear limitations on the franchisee's ability to source products from unapproved suppliers; (iii) the applicability of the force majeure clause in circumstances of supply chain disruption; and (iv) business continuity planning in the event of a supply chain disruption.

(c) Impact of New Technologies on Key Terms

Few franchise concepts have escaped the impact of the accelerating pace of technological changes disrupting traditional business models. Such changes are increasingly driving modifications to key provisions found in most franchise agreements. For example, the advent of third-party delivery providers has forced franchisors and franchisees in the restaurant industry to take a fresh look at how standard provisions concerning fees, royalties, advertising fund contributions, usage of the franchisor's trademarks, and even territorial exclusivity address situations where such providers' activities have become essential features of the store-level operational model. Similarly, the increased use of such sophisticated technologies also results in the generation of new species of customer data, the ownership, regulation, and use of which often is becoming a more frequent source of tension in many franchisor-franchisee relationships – especially if the franchisee is located thousands of miles away. An examination of all of the implications of these developments on the provisions of a typical international franchise agreement is beyond the scope of this paper, but franchisors looking to expand into international markets are well-advised to raise them with both their U.S. and local/foreign counsel before tendering a franchise agreement to a prospective franchisee.

You will find much of the process of negotiating your international franchise agreement will be similar to the process domestically, and, hopefully, the foregoing has provided sufficient food for thought to prepare you for the key differences.

F. FOREIGN FRANCHISE LAWS

In the last five decades, especially in the last quarter century, there has been a proliferation of franchise laws and regulations in countries outside of the United States of

America. Such laws and regulations underpin the legal documentation that is needed to successfully expand into foreign markets and also dictate the modifications/changes needed to adapt the franchise documents for the target jurisdictions.

A franchisor and its counsel need to be aware of any franchise disclosure and/or registration requirements in the country(ies) relevant to the potential deal, as well as franchise relationship laws that may affect the franchisor's rights on an ongoing basis (e.g. laws that restrict when a franchisor terminates a franchise agreement or laws that require certain terms in a franchise agreement). At a minimum, being aware of these laws gives the franchisor the opportunity to account for the increased costs of having to comply with local franchise disclosure and/or registration requirements when determining the initial franchise fee it wishes to charge for the rights to the territory, as well as the increased time that compliance with local franchise disclosure and/or registration requirements adds to the deal timeline. Franchise laws vary widely around the world, and countries continuously institute new laws or amendments to existing laws. In addition to the countries with franchise disclosure laws set forth in the chart below, certain countries have civil codes which effectively impose a disclosure requirement. For example, Austria, Germany and the Canadian province of Quebec all impose a duty of good faith on parties to an agreement to disclose provisions that may impose significant obligations. Below is a chart that captures franchise disclosure and relationship laws (excluding civil code requirements) around the world as of the publication of this paper:

Country	Disclosure Laws	Relationship Laws
Albania	✓	✓
Angola		✓
Argentina	✓	✓
Australia	✓	✓
Azerbaijan	✓	✓
Belarus		✓
Belgium	✓	
Brazil	✓	
Canada (only provinces of Alberta, British Columbia, Manitoba, New Brunswick, Ontario, Prince Edward Island)	✓	✓
China	✓	✓
Ecuador		✓
Estonia		✓
France	✓	
Georgia	✓	✓
Indonesia	✓	✓
Italy	✓	✓
Japan	✓	✓
Kazakhstan		✓
Kingdom of Saudi Arabia	✓	✓

Country	Disclosure Laws	Relationship Laws
Kyrgyzstan		✓
Latvia	✓	✓
Lithuania		✓
Macau	✓	✓
Malaysia	✓	✓
Mexico	✓	✓
Moldova	✓	✓
Mongolia	✓	✓
Netherlands	✓	✓
Romania	✓	✓
Russia		✓
South Africa	✓	✓
South Korea	✓	✓
Spain	✓	
Sweden	✓	
Taiwan	✓	
Thailand	✓	✓
Tunisia	✓	✓
Turkmenistan	✓	✓
Ukraine		✓
Vietnam	✓	✓

Franchisors that already must comply with franchise disclosure and/or registration laws in their home country may be in a slightly better position to implement a franchise program in an international jurisdiction with similar requirements because those franchisors should already have some familiarity with the process and should have a starting point when it comes to the franchise documents. That said, in light of significant jurisdictional differences, franchisors should expect to encounter additional hurdles. Among those countries that do require disclosure or registration of the disclosure document, the process, costs and requirements vary widely, highlighting again the importance of engaging local counsel early in the transaction.

When investigating foreign laws and regulations, franchisors should consider how these legal frameworks impact their expansion plans, including:

- timing of expansion (e.g., by requiring the franchisor to obtain licenses, permits and other such authorizations);

- costs of expansion, particularly in countries that require the development and operation of a specified number of corporate stores before franchising is permitted; and

- trends in courts that would favor domestic franchisees over foreign franchisors.

1. Disclosure Laws

A U.S. franchisor may be able to use its U.S. franchise disclosure document in certain countries with minor modifications, while in other jurisdictions the franchisor will need to prepare an entirely new, country-specific and local law compliant disclosure document that is relatively similar (such as in Canada, although Canada requires that a customized disclosure document be prepared for each candidate), or one that is much different from the typical disclosure document used in the U.S. (such as in Brazil and China). Some countries may regulate language requirements for the disclosure document and the franchise agreement, the timing of disclosure (and when and what documents must be registered), and the format of the disclosure document, while other countries do not provide any guidance on these issues. Further, certain countries have broader disclosure requirements than in the U.S., resulting in lengthier disclosure documents and burdensome disclosure obligations. For example, in certain jurisdictions, the disclosure document must be current every time it is handed out to a prospective franchisee, including updating the list of franchisees. The scope of disclosure in other countries is much narrower, however, and the disclosure document can be very short but equally burdensome in that the document must also be current every time it is handed out to a prospective franchisee.

Although registration of a disclosure document is not common in the majority of countries, some countries do require registration of the disclosure document or other documents, such as the franchise agreement. In addition, there are many countries that do not have franchise laws but where franchisors should file summary trademark license agreement to protect their intellectual property rights. As the international legal landscape surrounding franchising is constantly evolving, local counsel should serve as a resource on how to comply with any recent developments, especially when guidelines have not been established, or are in the process of being established, by the local governmental authorities.

2. Registration Laws

Certain countries require franchisors to submit the franchise agreement to a government agency for substantive review, translation and approval before the agreement can become effective. These countries tend to regulate various provisions of the franchise agreement, such as choice of law, dispute resolution, termination, restrictive covenants, and fees and currency. In some countries, this registration process can take months (e.g. Malaysia). In addition, government approval of the franchise agreement may be required in some countries with respect to trademark issues or customs requirements, but the franchisor can include language in the franchise agreement so that its effectiveness is contingent on obtaining such approvals. Certain countries (e.g., China, Indonesia and Vietnam) require that the franchisor maintain a franchise registration issued by the relevant government authorities in order to engage in franchising activities in the country.

3. Relationship/Agency Laws

In addition to the disclosure and registration laws in certain countries, franchisors should also consult with local counsel regarding relationship laws or other laws that may have an effect on the franchise relationship so that the franchisor has the appropriate expectations when attempting to enforce its rights under the franchise agreement. Generally, international relationship laws are similar to those laws that franchisors encounter in the U.S., which require the franchisor to have good cause to terminate (with a cure period), to not renew, or to disapprove the transfer of a franchise agreement. In addition, many international relationship laws also require that certain provisions are covered in the franchise agreement (i.e. Mexico).

In domestic franchise agreements, the franchisor's grounds for termination are often broken down into three categories based on the severity of the default committed by the franchisee – defaults that are grounds for automatic termination without notice from the franchisor, defaults that are grounds for immediate termination upon written notice from the franchisor and defaults that are grounds for termination only if the franchisee fails to cure the default within a defined period of time after the franchisor provides written notice of that default to the franchisee.

In international franchising, the practical and legal issues involved with terminating the franchisee often warrant a more conservative approach to termination. Simply put, the franchisor may not be able to timely and efficiently enforce the termination of the franchisee in the territory (that may be halfway around the world) and, as a practical matter, the franchisor may not be in a position to take over the franchisee's operations in the territory even if the termination can be effectuated. The latter is especially a concern where the franchisor is using the master franchise model because the franchisor will often be forced to consider how to handle the subfranchise agreements that the franchisee entered into with subfranchisees in the territory. Where there is no potential alternative franchisee in the market, terminating the franchisee in this instance may mean the franchisor would need to operate its concept in the territory on a long-term basis, or face the implications of a full market exit. It also is more common for a franchisee internationally to simply ignore the franchisor. As noted elsewhere in the paper, having a letter of credit in place can be great leverage for the franchisor to encourage compliance and avoid termination.

While there are certain actions on the part of the franchisee that should always be grounds for automatic termination of an international franchise agreement (e.g., bankruptcy or attempted illegal transfer) or termination by the franchisor without an opportunity to cure (e.g., abandonment, serious criminal conviction, violation of in-term covenants against competition, attempt to file trademark applications for franchisor's brand, and/or violation of franchise sales laws), the franchisor should be careful as to how it treats other defaults under the agreement given the increased costs and uncertainty involved in terminating an international franchise relationship – especially if the franchisee is responsible for administering the system in the territory and the franchisor is not in a position to take over that system.

The post-termination obligations of the franchisee under an international franchise agreement should require that the franchisee: (1) immediately cease all offers and solicitations of subfranchisees, as well as all franchise sales, in the territory (if applicable); (2) promptly de-identify its stores, discontinue its use of the franchisor's proprietary marks, and cease holding itself out as a former or existing franchisee or licensee of the franchisor or the system; (3) pay all amounts due and owing the franchisor under the agreement as of the date of termination (including interest, if any), which may include reimbursing the franchisor for the legal costs it incurred in terminating the agreement; (4) return all proprietary materials and materials that display the franchisor's proprietary marks to the franchisor, including the translated version of any documents that the franchisee may have translated for use within the territory (e.g., an operations manual); (5) immediately cease all use of the materials listed in (4); and (6) comply with all post-term covenants against competition.

In addition to relationship laws, in certain countries, particularly in the Middle East, Spain, Latin America and those that follow civil law, franchisees that are independent contractors and generally outside of the scope of labor laws may be considered to be the franchisor's sales representatives or commercial agents, which would subject the franchisor to local agency laws. Such agency laws protect the franchisee from an "unjust" termination by the franchisor, and may provide extra-contractual indemnification to a franchisee in the event of termination, modification or non-renewal of the relationship by the franchisor without "just cause" (as defined under such laws), even when such termination, modification or non-renewal is done strictly in accordance with the terms of the agreement. These agency laws may apply to any local person or entity that acts as an independent, commission-based sales representative (which is generally outside of the scope of a typical franchise agreement) or to a buy-sell distributor (which may be outside of a franchise arrangement, depending on whether the type of franchise includes a distribution element), or to a person or entity that promotes or offers products and/or services of a principal entity (in which case the application of the law to a franchise agreement may be proper). The stringency of international agency laws tends to vary widely, and application of the laws can be fact-specific; therefore, franchisors should consult with local counsel regarding the possible application of any agency laws in the territory.

G. TRADEMARK/INTELLECTUAL PROPERTY CONCERNS

A company's intellectual property (or "IP"), including the traditional assets of patents, trademarks and copyright as well as other "know-how" - which is for many the "secret sauce" of their brand - is a key asset in any industry. To be sure, for several companies engaged in franchising, the IP is the only asset actually shared with their franchisees if franchisees are required to procure products and supplies from third parties. Often, the royalty, initial fee and territory exclusivity fees all relate back to the IP involved in the deal.

Value in franchise systems is based on "exclusivity" – of the trademarks, brand, proprietary technology, know-how, confidential information and the system. It is important to protect and strategically manage the use of these intangible assets both before and

during international expansion, as not doing so beforehand may jeopardize – or perhaps even prevent – a franchisor from taking even the first steps towards going international. The efforts to protect a franchisor's IP will be subject to different intellectual property regimes in foreign markets, so franchisors will need to consider how and when to register their trademarks in the foreign market (as well as conduct due diligence on the distinctiveness of their marks as compared to the marks of other local market players).

Failure to secure a franchisor's IP initially, define the grant of any rights to and in the IP clearly, and protect the IP from third party infringers will diminishes the value of the IP and the company's brand and could undermine the anticipated fee structure. Suffice it to say that protection of IP is critically important both for franchisors and franchisees in foreign territories. Additionally, there may be cultural issues in certain territories that require some creative changes to the franchisor's IP package (as more fully discussed in Section 2(c) below).

Along with protecting their customary IP assets such as trademarks and copyrights, franchisors will want to protect their proprietary technology, know-how, and confidential information to decrease the chances of diluting their competitive advantage during expansion. For example, local laws may impose restrictions on how long proprietary technology may be exclusive (i.e., patent terms) or how long a party to an agreement can be expected to keep "confidential information" actually confidential (i.e., the survivability of obligations related to confidentiality).

1. Securing Your IP under Local Law

If a franchisor's business is heavily patent-based, it is essential that the company plan well in advance for the patents' international use. Assuming the franchisor first applied for protection in the United States, then, within one year of that filing, the company will typically file an international application under the Patent Cooperation Treaty (a "PCT application") with the World Intellectual Property Organization ("WIPO") to being the process of protecting the patent internationally. The PCT application is then examined, and a search report is provided by WIPO that assesses the invention's compliance with various patent laws. Within 18 months of filing the PCT application, the franchisor must decide into how many of the more than 150 PCT-participating countries to file its application (and then pay the corresponding national fees for each territory selected). The types and number of countries entered depends on a number of factors, including the results of the search report and commercial interest in the invention. For trademarks and copyrights, the franchisor will need to work with local counsel in its target jurisdiction to file applications for protection in a timely manner. Time from application to registration varies by market, so it is in the franchisor's best interest to apply as soon as possible. To that point, depending on whether the jurisdiction is "first to file" (i.e., trademark protection is granted to the first party to successfully file for registration) or "first to use" (i.e., trademark protection is granted to the first party to actually use the trademark commercially in the local market), a franchisor may want to consider applying well in advance of actual market entry - perhaps even before identifying a potential local partner. If not, franchisors risk that third parties, and even potential candidates, register their trademarks in a country, which can be very costly for a franchisor to regain. Even in

jurisdictions where priority is granted to early applicants – such as the European Community and China - rights may be subject to cancellation upon challenge if verifiable use has not been established within the specified time frame. If a franchisor is unable to obtain protection of its trademark rights, in some jurisdictions securing a copyright may help to at least protect its brand's name. Additionally, local counsel can advise the franchisor as to whether applications using stylized or local character formats can help secure the brand's identity abroad.

Although it may be tempting to rely on the resources of a local partner and authorize them to register and maintain the franchisor's IP, that path can lead to ruin in the event of a desired market exit, transfer, or termination (as a franchisee may not cooperate with the franchisor's attempts to deregister, transfer, or terminate the franchisee's license to use the IP assets). It is instead highly advisable that the franchisor, as the owner and developer of the IP, maintain direct responsibility for the process and register its IP in its own name (as opposed to the franchisee). Though having direct responsibility for registering the IP may be more costly and time consuming, this step will make it easier in the event the franchisor needs to make a critical brand decision in the future – including the possible need to terminate the franchise agreement(s) and/or withdraw from the territory altogether. Franchisors can factor in the costs of registering and maintaining the IP in a country into the intial and ongoing fees as an additional expense.

2. Granting License Rights to the IP

Accurate drafting of the language in the franchise agreement granting a local partner the right to use a franchisor's IP is important whether domestic or international. When franchising abroad, however, the risk is typically greater since franchisors often do not maintain personnel in the foreign market to police any misuse of the IP. Such misuse may include a franchisee using branded supplies in an unauthorized way, using competitor-branded or other unauthorized merchandise in the operation of its business, or failing to utilize updated versions of the franchisor's IP. In drafting its franchise agreements, it is important that a franchisor include language that clearly details which IP is to be used, the limited ways in which it is to be used in the operation of the business, and the specific penalties for misuse. Franchisors also should use their operations manual to regulate the use of IP.

(a) Monitoring and Enforcement

As in the United States, the acts of developing, registering, and licensing the IP are not the end of the protection process. Instead, a brand owner should be prepared to invest the time and energy needed in order to maintain the validity of the registrations as well as effectively monitor any potential infringement by third parties. Depending on the scope of its international system, a franchisor may find it worthwhile to invest in a third party service to assist in the IP monitoring process. It is important, too, to get a sense of the likelihood of infringement in the target market and the time and expense of enforcement processes generally in advance of entering the market, especially for franchisors in the retail fashion and merchandise space. If a franchisor is operating in a

high-infringement market, it may want to anticipate some of the cost of an inevitable action by building it into the final franchise fee structure in advance.

(b) Protecting the "Secret Sauce"

What about the "secret sauce"? Just as in the United States, in most territories abroad, "know-how", or the particular formula of key methods and inputs that differentiate your brand, is not protectable under a formal registration regime. Therefore, a franchisor's ability to protect such rights lies primarily in contract – specifically, the franchise agreement. One important clause is the confidentiality provision; franchisors should be able to share all information necessary for their local partner to operate the business without risk that the partner could then share such information with others who may gain a competitive edge. Requiring confidentiality from franchisees, from the day the relationship is first discussed through the last day of the relationship under the franchise agreement, is of central importance.

Another key provision is the noncompetition provision. Franchisors are advised to require franchisees to promise allegiance to the franchise brand by agreeing to refrain from participating in any competing business during the term of the relationship and for a period of time thereafter. This noncompetition requirement should be extended in the agreement as far as reasonable to protect the know-how of the business. This may mean franchisees will be required to secure noncompetition covenants from key employees and executives in their business that may have access to such protected information, and be required to police their activities and report to the franchisor if any of those individuals attempts to work for a competitor. There will likely be some negotiation over this issue, as franchisees will argue it is difficult or burdensome to police former employees. There may also be legal restrictions on post-termination noncompetition provisions. Still, a fair result should be achievable given the importance of protecting these rights to both the franchisor and the franchisee.

(c) Adapting to Cultural Differences

One of the exciting aspects of franchising abroad is that cultural and language differences may require a franchisor to adapt your existing IP to the requirements of local law or custom. Take, for example, the Starbucks logo. While the original siren depicted in their logo was acceptable to customers in many of their markets, including the United States and other international markets, the company was unable to use the image of a semi-nude female in their logo in Saudi Arabia. They therefore adapted their mark by eliminating the siren to conform to the limitations of local law and custom. This is but one example of why franchisors should work with local counsel, local partners, and consumer research firms in their target jurisdictions to determine what, if any, changes may need to be made.

H. OTHER LOCAL LAWS

1. Imports, Exports, Duties and Customs and Exchange Controls

In addition to the laws that impact the franchise sales process and ongoing relationship, franchisors must also examine the logistical feasibility of setting up a franchise system in a foreign jurisdiction and the related costs. Establishing a supply chain is a key factor for almost every type of franchise system – franchisees will need a way to procure proprietary and other products utilized or sold by the franchised business (such as ingredients and other goods), as well as any required computer and POS systems and related hardware and software, uniforms, signage, and other components of the franchisor's brand standards. To avoid import/export issues, franchisors may be able to find local sources for the goods and services franchisees need to establish their franchised business; however, this may prove difficult depending on the type of goods and services used in the franchise system (particularly any proprietary goods and services) and/or the current state of the local economy. Franchisors will likely need to invest considerable time and money investigating local resources and import restrictions if they wish to establish a possible supply chain in the territory, as well as sending personnel to the territory to explore the local resources (or engaging a local person with relevant experience).

Certain countries may have restrictions on importing or exporting the products franchisees may need to establish and operate their franchised business, either based on the type of good, the destination or origination country, or quotas. Further, the cost of shipping goods to or from the territory, including import or export duties, and any applicable taxes must be borne by someone – either the franchisor or the franchisee – which could have a huge impact on the viability of the franchise system, if the majority of the goods used to establish a unit franchise cannot be locally sourced or must be shipped to or from other countries. Import and export duties can be significant, although there may be trade agreements in place that can reduce the amount of the import duty or waive it altogether. Further, if products are imported into another country prior to the importation into the country of final destination, it is possible that duties may have to be paid twice: once in the intermediate country; and again when imported into the country of final destination.

Another piece of the import/export puzzle is currency, and the ability to buy and sell goods at the prevailing currency rate in the territory. Currency rates affect the calculation and payment of fees under the franchise agreement both in the host country and repatriating such fees to the franchisor's home country.

Especially in emerging markets for product-based franchisors, exporting from the foreign jurisdiction to other, high cost markets is an opportunity for the most trusted, local franchise partner.

2. Local Ownership Laws

While foreign expansion may be viewed favorably by many countries for the potential economic boost that may result from new businesses, other countries tend to be more protective over their economic and political sovereignty and thus have enacted laws restricting foreign ownership in local businesses. China, Saudi Arabia, and the UAE are prime examples of countries that restrict foreign investment. Such restrictions vary by country, but can include: (i) a requirement for the business to be established by a local citizen or entity, (ii) maximum foreign investment ownership thresholds, and (iii) restrictions on foreign ownership in certain industries which may be culturally sensitive. Some countries also regulate the maximum amount of the royalties and other fees payable under franchise agreements and/or mandate that certain items be sourced solely from other local businesses (most often in businesses that are especially important to the local economy or culture). The potential costs related to each of these issues must be considered by the franchisor in deciding whether to enter a new market.

3. Competition and Antitrust Laws

Many countries, such as those in the European Union, have adopted competition and antitrust laws more restrictive than, those in the United States. Such laws can include prohibitions against collusion to limit consumer selection; price fixing; control over resale prices; control over internet sales; price discrimination; tying; false advertising; exclusive arrangements; exclusive and/or restricted territories; abuse of dominance; and restrictions on the right to challenge trademarks. It is critical to have an understanding of the competition and antitrust laws in any jurisdiction in which you operate your franchise system as violation of competition and antitrust laws may have both monetary, civil/administrative or criminal consequences.

As discussed earlier in this paper, confidentiality and in-term and post-term noncompetition covenants are among the hallmarks of a franchise agreement, each of which are a means for franchisors to protect their brand, proprietary materials, and trade secrets, and, with respect to noncompetition covenants, to ensure that a franchisee cannot use the franchisor’s proprietary information and know-how to compete with the franchise system. Such covenants are ubiquitous in U.S. franchise agreements, although the enforceability of noncompetition covenants can vary by state and generally must be reasonable in terms of scope and duration. Confidentiality covenants for the purpose of protecting the franchisor’s trade secrets are generally enforceable, both in the U.S. and abroad.. Noncompetition covenants, on the other hand, often face a high level of scrutiny and are against public policy in many countries. For example, in Canada, post-term covenants are only enforceable when drafted narrowly to protect the franchisor’s interest and are not unreasonable.

U.S. franchisors expanding to the European Union usually find that the anti-competition restrictions in the European Union are also stricter than what the franchisor is accustomed to in the U.S. The Treaty on the Functioning of European Union “prohibits all agreements between companies which may affect trade between companies within the European Economic Area ("EEA") and which have as their object or effect the

restriction, prevention or distortion of competition within the EEA." Noncompetition provisions with a term of no more than five years (including any renewals) are exempted by the European Commission. However, the transfer of substantial know-how usually justifies a non-compete obligation for the whole duration of the franchise agreement, provided that certain conditions are met. Further, the only exempted post-term noncompetition covenants are those that are limited to the premises and land from which the franchisee operated during the term of the franchise agreement, the goods or services the franchisee purchased that are indispensable to protect the know-how of the franchisor, and the one-year period following termination of the franchise agreement.

4. Indemnification

In domestic franchise agreements, franchisors typically require the franchisee to indemnify the franchisor (and its affiliates) for claims and liabilities arising from the operation of the franchised business and the franchise relationship generally. The indemnification provisions work to protect the franchisor from claims from the franchisee's customers or clients, employees, vendors or other third parties. In foreign jurisdictions, indemnification provisions are usually enforceable, but some countries require the indemnified party to mitigate its damages and prohibit a party from receiving indemnification for its own intentional acts or gross negligence. Further, some jurisdictions may evaluate the reasonableness of the indemnification provision and modify overly broad provisions that include claims which were not foreseeable at the time the parties entered into the agreement.

5. Dispute Resolution, Governing Law, and Venue

While U.S. franchisors generally have wide latitude to determine dispute resolution, governing law, and venue provisions in franchise agreements (subject to franchise laws in certain states), local counsel is essential in identifying any restrictions or limitations on these provisions that may exist within the territory. For example, pursuant to the franchise laws of the applicable Canadian provinces, a franchisor cannot avoid a statutory claim based on a breach of such laws by choosing a foreign law to govern the franchise agreement and any provision in a franchise agreement purporting to restrict venue to a forum outside the relevant province is void with respect to a claim the franchisee has under the franchise legislation. As discussed in greater detail below, when operating in Islamic countries, franchisors need to be aware of Sharia law, the religious law and Code of Islam that governs the local judicial system. Further, while many U.S. franchisors choose litigation to resolve their disputes, arbitration is typically recommended for resolving disputes with international franchisees because, provided the franchisee's home country is a party to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the "New York Convention"), it is generally much easier to enforce an arbitration award than a court award. Nevertheless, the enforcement of awards obtained in foreign jurisdictions is not a simple task and local counsel should be used as a resource on this issue.

6. Personal Guaranties and Letters of Credit

It is common for franchisors to require a personal guaranty from the individual owners of a franchisee entity (and sometimes from their spouses) so that the individual owners remain personally liable for the franchisee's obligations under the franchise agreement. While a personal guaranty is generally acceptable in foreign jurisdictions, there are some exceptions of which franchisors should be aware, such as in the Canadian province of Alberta. Under Alberta's Guarantees Acknowledgment Act ("GAA"), a personal guaranty does not have effect unless the guarantor appears before a lawyer and both the guarantor and the lawyer acknowledge in a signed certificate (in the required form) that they understand the contents of the guaranty. While Alberta's GAA is definitely not the norm, if a franchisor is concerned about the overall financial viability of the local franchisee, it should seek guidance from local counsel regarding the enforceability of a personal guaranty in the territory, as well as any formalities that must be followed.

In addition, franchisors often find that mature international franchisee conglomerates are unwilling to provide personal guaranties from its owners or even a corporate guaranty. In such instances, franchisors often rely on a letter of credit in lieu of a personal guaranty. Where a franchisor is concerned that it may face challenges enforcing the terms of the franchise agreement in certain jurisdictions, it may be prudent to obtain a letter of credit in every instance as the letter of credit can later be used as leverage to encourage the franchisee to comply with the agreements and, ultimately, to participate in arbitration if the parties are unable to resolve the dispute. It is recommended that the letter of credit be issued from an international financial institution with a presence in the U.S., and a draft of the proposed letter of credit should be reviewed by experienced counsel to confirm that it was issued correctly so that no further action will be required if the franchisor wishes to draw upon it.

7. Religious Concerns

Religious restrictions and traditions around the world can have a significant impact on certain types of franchise systems, as well as contract provisions. Franchisors in the food service, restaurant, and hospitality industries should be aware of the various dietary and food preparation restrictions under the Buddhist, Hindu, Islamic, and Jewish religions, as well as other faiths. Franchisors must either become familiar with the dietary guidelines to make adjustments to required menu and/or ingredient specifications for a particular territory, or allow the franchisee the flexibility to adapt the menu items to accommodate any dietary or food preparation restrictions applicable to its territory. Further, franchisors will likely have to accommodate the religious holidays and observances in certain faiths, such as Sabbath or daily prayer rituals. In addition, in certain Islamic countries, Sharia law, the religious law and code of Islam, governs the judicial system. The degree to which Sharia law plays a factor can vary - Saudi Arabia has a classical Sharia law system, while other countries, such as the United Arab Emirates, have a mixed legal system of Sharia and secular law. Sharia law prohibits enforcement of certain provisions commonly found in franchise agreements, such as the payment of interest on overdue amounts and noncompetition provisions.

8. Privacy Laws

Local privacy laws will affect many aspects of doing business abroad, particularly as these laws apply to the franchisor-franchisee relationship, and the relationship and data flow between the franchisor and the franchisee's customers. Some countries may have several levels of privacy laws – both at the federal and perhaps state/provincial or some other regional level – that must be taken into account when expanding internationally. In addition to local privacy laws, it is also important to consider the impact of other international privacy laws from outside the jurisdiction in which you are looking to expand. For example, the European Union General Data Protection Regulation, has extra-territorial application and could apply to the data processing activities of businesses located outside Europe. Consulting with local privacy counsel to assess how local privacy laws will affect your data protection and processing obligations and understanding the operational consequences of same, will be critical when expanding to a particular country or region.

I. EXTRA-TERRITORIAL APPLICATION OF U.S. LAWS

1. US Franchise Laws

When seeking to expand globally, in addition to exploring numerous international laws, U.S. franchisors should also reexamine domestic franchise laws and regulations which may apply to their international franchise sales. While, at a federal level, the Federal Trade Commission's Franchise Rule, 16 CFR Part 436 (the "FTC Rule") only applies to the offer or sale of a franchise to be located within the U.S. (and its territories and possessions (such as Puerto Rico)), some state franchise registration and disclosure laws may apply to an international franchise transaction. For example, the franchise registration and disclosure laws in New York apply worldwide for franchisors located in New York or that offer or sell franchises in New York. Although franchisors generally are able to obtain an exemption from the application of the New York law, affirmative action must be taken by the franchisor to obtain the exemption from the state regulatory authority.

2. Anti-Corruption Laws

Under the Foreign Corrupt Practices Act ("FCPA"), the anti-bribery provisions make it unlawful for any "domestic concern," certain issuers of securities, or anyone acting on their behalf (whether a U.S. person or not), or anyone on U.S. soil, to provide money or other benefits to any foreign government official in order to obtain or retain business. The law also imposes certain accounting and recordkeeping requirements and internal controls on "issuers" (corporations that have issued securities registered in the U.S. or that are required to file periodic and other reports with the U.S. Securities and Exchange Commission). The anti-bribery provisions are enforced by the U.S. Department of Justice, while the accounting and internal controls provisions are enforced by the SEC.

To constitute a violation of the FCPA's anti-bribery provisions, an offer, promise, or authorization of a payment, or a payment, to a foreign government official of money or anything of value must be made "corruptly" – there must be a specific intent to (i) influence an official act or decision of a foreign government official, (ii) induce a foreign government official to do or omit to do any act in violation of his or her lawful duty, (iii) induce a foreign government official to use his or her influence with a foreign government to affect or influence any government act or decision, or (iv) secure any improper advantage. The FCPA also prohibits corrupt payments to foreign government officials through third-party intermediaries, such as consultants and representatives. Companies cannot avoid liability by remaining deliberately ignorant of the actions of third parties that may violate the FCPA.

Franchisors, like other covered companies, must abide by the FCPA's anti-bribery provisions. While there is no specific guidance on franchisor FCPA liability for franchisee actions, in light of the increased enforcement of the FCPA and the nature of the franchise relationship, franchisors could potentially be found liable under the FCPA for actions taken by its franchisees that are operating internationally, depending upon the franchisors' control over its international franchisees, particularly if there is a failure to exercise due diligence with respect to those franchisees. To date, no U.S. franchisor has been subject to an enforcement action by the U.S. Department of Justice or the U.S. Securities and Exchange Commission, but any such action could result in a franchisor being involved in criminal and civil litigation, paying penalties, fines and disgorging profits, and facing reputational losses.

Although FCPA liability depends on a corrupt intent, a lack of knowledge may not be enough to avoid liability, because the FCPA can be enforced against entities that are "willfully blind" to violations. Franchisors' claims of lack of knowledge (and corresponding lack of intent) can be strengthened by a franchisor putting in place controls and policies to deter and discover FCPA violations. If a franchisor does so, however, it is important that the controls and policies be enforced and not simply be created on paper.

- an appropriate FCPA compliance program (including compliance manual, education, and internal enforcement to ensure corporate compliance with FCPA requirements);

- due diligence of business partners, whether of agents, representatives or franchisees (particularly in jurisdictions where FCPA risks are heightened), including the use of due diligence questionnaires and thorough background checks;

- inclusion of strong contractual language in franchise and other agreements regarding FCPA prohibitions and obligations, including the submission to the franchisor of annual compliance certifications; and

- implementation of an FCPA reporting and monitoring system.

3. Anti-Terrorism Laws

The U.S. Office of Foreign Assets Control ("OFAC") administers and enforces economic sanctions, which are intended to deprive targeted countries, groups and individuals of access to their property in the United States, as well as the benefits of trading with the U.S. and using the U.S. banking system. OFAC administers two types of sanctions: individual and country-specific.

- Individuals. OFAC maintains a list of Specially Designated Nationals ("SDN") with whom U.S. persons are prohibited from doing business. SDNs include terrorists, drug-traffickers, and entities associated with hostile governments. Transactions also are prohibited with SDN-owned or controlled entities, which may not appear on OFAC's list of SDNs. OFAC frequently updates the SDN list, currently found at: https://home.treasury.gov/policy-issues/financial-sanctions/specially-des ignated-nationals-list-data-formats-data-schemas.
- Countries. OFAC maintains country-specific sanctions. Sanctions programs vary, but the broadest sanctions prohibit U.S. persons from engaging in nearly all business operations in or involving the sanctioned country. Countries subject to comprehensive sanctions include Iran, Syria, Cuba, Sudan and Russia. OFAC also employs country-specific sanctions that prohibit only limited transactions within the country – not all transactions. O FAC's website (https://home.treasury.gov/policy-issues/financi a l-sanctions/sanctions-programs-and-country-information) includes extensive information about country-specific sanctions, including a list of sanctioned countries and the specific prohibitions against doing business with such countries, which is periodically updated.

In conducting their direct business activities, U.S. franchisors are responsible for complying with the sanctions regulations established by OFAC. In other words, franchisors should not engage in business with persons on the SDN list or in prohibited business with sanctioned jurisdictions. Recently, there has been significant activity imposing sanctions on Russia and certain individuals in response to Russia's invasion of Ukraine. In addition, U.S. franchisors face the potential of liability for transactions between a foreign franchisee and a sanctioned entity. OFAC has not issued any guidance on liability in the franchise context, but it is likely that, if OFAC found that the franchisor had control over the franchisee, the franchisor would be liable for the franchisee's conduct in violation of OFAC sanctions. Risks are greater to the extent that the franchisee engaged in business with a sanctioned person or entity in furtherance of its franchised operations and/or if the franchisor controlled the actions, policies or personnel decisions of a franchisee. Franchisors could certainly point to the elements of the franchise relationship that make the franchisee independent of the franchisor and to their own policies designed to comply with U.S. sanctions. Nonetheless, OFAC enforcement is aggressive, , and any investigation commenced would likely require the franchisor and other targeted companies and individuals to devote significant time and resources in responding to the investigation, even if the franchisor is found to have not violated U.S. law. Because

sanctions regulations create a strict liability regime, U.S. companies should consider conducting a risk assessment and establishing appropriate compliance controls. Controls could appear in franchise agreements, screening programs, and processes for making goods, services and software available to franchisees. If franchisors provide any type of financing, guarantee, insurance or management service to a foreign franchisee, enhanced review and controls may be appropriate. Franchisors can consider taking steps to reduce potential liability, including performing due diligence on business partners, demanding compliance from franchisees and other partners, creating a compliance program, and responding promptly to suspicious activity.

4. Anti-Boycott Laws

Antiboycott laws prohibit or penalize U.S. companies for participating in foreign-initiated boycotts and embargoes that the United States has not sanctioned. The main boycott that the laws are designed to counteract is the Arab League boycott of Israel. However, these laws extend beyond the boycott of Israel and apply to any boycott unapproved by the U.S. government. U.S. companies are subject to two antiboycott laws, the Export Administration Act ("EAA") and the Ribicoff Amendment to the Tax Reform Act ("TRA"). The TRA and the EAA are separate regulatory regimes, which vary in their structure, application, penalties and prohibited activities. Generally speaking, the following activities are prohibited: refusals or agreements to refuse to do business with or in a boycotted country or with a blacklisted company; discriminatory actions or agreements to discriminate against a U.S. person on the basis of race, religion, sex, or national origin; furnishing information or agreements to furnish information about the race, religion, sex, or national origin of a U.S. person; furnishing information or agreements to furnish information about business relationships with or in a boycotted country or with blacklisted companies; and implementation of letters of credit containing prohibited boycott terms or conditions.

Boycott requests can assume many forms, some of which may not be obvious. Training of relevant staff therefore is critical to help identify red flags. The EAA and TRA not only restrict compliance with boycott requests, but also require companies to report any request to support an unsanctioned boycott (even if there is no intent to comply with the request). Although countries that are members of the Arab League are the predominant source of boycott requests, other countries have also asked U.S. companies to participate in a boycott (e.g., Bangladesh, Malaysia, Pakistan, Iran, and Nigeria).

Franchisors, like other covered companies, must ensure that their direct actions do not run afoul of the U.S. antiboycott regime. Regarding liability for franchisee behavior, there is no direct statutory or regulatory language or agency guidance that addresses the liability of franchisors for franchisees' violations of antiboycott laws. A franchisor seeking to avoid liability for franchisees' actions may argue that a franchise is independently owned and operated, and that franchisors do not exercise requisite control over franchisees' routine business activities – particularly those that may be implicated by boycott laws (e.g., franchisee purchase orders). Being able to document such separation, coupled with a strong compliance program tailored to the franchisor's own activities, would be the best approach.

A franchisor may reduce its potential liability by adopting an appropriate compliance program designed to uncover any violations of antiboycott laws; educating key employees; and making clear to franchisees, in franchise agreements and otherwise, that the franchisor cannot – and will not – take actions in violation of U.S. antiboycott laws. Franchisors also should consider voluntarily disclosing any known violations, in consultation with legal counsel.

5. Anti-Money Laundering Laws

Money laundering is the process of disguising proceeds from illegal activities or funding illegal activities by mixing those proceeds with legal funds. In the United States, money laundering is investigated and prosecuted by several government agencies, including the Department of Justice, the Internal Revenue Service, the Treasury Department's Financial Crimes Enforcement Network ("FinCEN"), and the Department of Homeland Security. Many of the anti-money laundering ("AML") laws are collectively known as the Bank Secrecy Act ("BSA") and are administered and enforced through regulation by FinCEN. Violations can trigger civil and criminal penalties.

Generally applicable AML laws prohibit laundering money or aiding and abetting money laundering. Money laundering generally requires intent and knowledge of illegal activity, though willful blindness can suffice to show intent. These laws also require reporting certain activities, such as transactions of over $10,000, or bringing the same amount into or out of the United States. Generally applicable AML laws apply to franchisors, like other businesses. For example, a franchisor may not knowingly engage in financial transactions with funds of property acquired through illegal activities, or engage in financial transactions designed to avoid transaction reporting requirements. Franchisors may incur liability if they intentionally launder money, intentionally aid and abet a franchisee's money laundering, or are willfully blind to receipt of illegal proceeds. The more removed franchisors are from the illegal activity, the more attenuated liability is likely to be.

Because financial institutions will scrutinize franchise accounts and transactions for signs of money laundering, franchisors should consider implementing compliance programs to both govern their own business activities in compliance with AML laws and also minimize the risk of franchisee misconduct. Compliance measures to consider include identifying compliance officials; screening potential business partners; educating key personnel regarding AML laws and compliance requirements; conducting continual risk assessment, and being aware of potential red flags in proposed and existing business relationships; requiring compliance from business partners and franchisees; and conducting internal audits.

J. CONCLUSION

With continued globalization of world economies, proliferation of social media, increased education of consumers, modernization of intellectual property protections, and sanctions relief afforded by the United States and the European Union, establishing or expanding the global footprint of one's franchise presents many exciting opportunities.

Global brand recognition brings strategic advantages and positive benefits to franchisors and their business partners alike who are looking for early entry into new markets, or seeking to enlarge already established territories.

Whether franchising in a developed country or an emerging economy, there are several fundamental issues international franchisors must consider, including the strength of the overall business case for their decision to expand internationally, the qualifications of potential international partners, potential supply chain issues and operational controls, as well the financial incentives and negotiating points involved in such deals. While there are many tools and resources available to assist franchisors in making these decisions -- including on-line forums, trade shows, third party due-diligence companies, and legal counsel -- there is perhaps no better resource than a brand owner's own ability to recognize its strategic strengths, understand its limitations and engage with consumers on a competitive global stage.

Professional Biography for Liz Dillon

With nearly 20 years of experience, Liz Dillon counsels growing and experienced franchisors to expand and maintain their franchise systems. She also assists startup franchisors to develop and position their franchise systems for growth both domestically and internationally. Liz also leads the firm's Franchise & Distribution Practice Group. Liz manages the franchise registration process for many well-known and emerging brands every year and has worked with numerous startup franchisors. She has helped franchisors expand into Latin America, the Caribbean, Asia, Europe, Africa and the Middle East. She brings extensive knowledge and experience in preparing and registering disclosure documents, as well as franchise, development, and supply agreements. Liz also assists clients through mergers and acquisitions, providing franchise, licensing and distribution expertise for transactions. In addition to representing franchisors, Liz represents other companies in the myriad of legal issues involved with the distribution of goods. She advises on matters including dealer / distribution agreements, international sale of goods, and avoiding franchise and business opportunity laws (accidental franchise). Liz is ranked in Chambers and Chambers Global.

Professional Biography for Andraya Frith

Andraya Frith is Chair of Osler, Hoskin & Harcourt LLP's National Franchise and Distribution Practice Group, one of the most frequently recommended law firms for franchise law in Canada and an elected member of the Firm's Partnership Board. She is also Co-Lead of Osler's Retail Practice Group and Co-Founder of Osler Dash, a platform that automates the franchise disclosure and contracting process. She practices commercial law with an emphasis on retail, franchising, consumer protection, supply chain, distribution, and e-commerce law. With nearly 25 years of experience, Andraya is a trusted advisor to Canadian and International franchisors, retailers and consumer-facing businesses of all sizes operating in a broad range of industries, including quick service restaurants, consumer goods, financial services, consumer and commercial lending and leasing, food and grocery, pharmacy, oil and gasoline, automotive, car rental, real estate and hospitality. She counsels franchisors on structuring international and domestic franchise transactions and preparing "best in class" franchise agreements and franchise disclosure documents for use in Canada's increasingly complex franchise regulatory environment. Andraya has developed particular expertise on advising foreign franchisors and retailers expanding their operations to Canada. She helps them maneuver through significant judicial, statutory and cultural differences between their home states and Canada to help ensure a smooth and successful entry into the Canadian market. Andraya is ranked in Chambers Global, Chambers Canada: Canada's Leading Lawyers for Business, in Franchising (Band 1) and Retail, Who's Who Legal: International and Canada (Franchise Law), Who's Who Legal: Thought Leaders: Global Elite (Franchise Law), and the Franchise Time Legal Eagle. Andraya is lauded by her peers as "one of the top players" in her field, and "in a league of her own".

Professional Biography for Larry Oberly

Larry joined SP Franchising, LLC, dba SpeedPro in November 2017 as its President and CEO and has recently been promoted to CEO and Chairman. SpeedPro, a leading wide-format printing franchisor with more than 120 U.S. franchisees. Prior to joining SpeedPro, he was a RE/MAX VP of its Domestic Operation for his first eight years and VP of its Global Operation for his last eleven years growing the company to nearly 4,000 offices, 50,000 agents across more than 110 Countries and Territories. Prior to RE/MAX, Larry was a multi-unit franchisee for six years and was an inaugural member of the AAFD Fair Franchising Standards Committee in the mid-1990s. While at RE/MAX Larry was responsible for the systematic growth strategy and development of its Master Franchisees and Sub-franchisees of regional owners and office franchisees. He is a Certified Franchise Executive with the IFA since 2013, serves on the Entrepreneurship Advisory Board at the University of Colorado – Denver, is a member of the IFA International Committee, and is a past, guest presenter for the Georgetown Franchise Management Program. Larry has a passion for global franchising, growing franchisee wealth, and building effective global development and support operations.