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**UNIQUE AND OFTEN OVERLOOKED ISSUES AND
LIMITATIONS ON DOING BUSINESS IN INTERNATIONAL
FRANCHISING**

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ON DOING BUSINESS IN INTERNATIONAL FRANCHISING**

I. INTRODUCTION

Regulatory surprises when franchising internationally can take many shapes and forms. While some of these surprises can be found in a country's franchise law, just as often the source of an unanticipated legal consideration can be found in that nation's commercial agency law, distribution law, anti-trust (or "competition") law, intellectual property law, or in the laws generally applicable to all in-bound investments.

These laws can have an impact at any stage of the franchise relationship lifecycle, whether that takes place: in the courting phase, the contracting phase, during the term of the relationship, or upon termination or expiration of the relationship.

The litany of issues that may arise presents an embarrassment of riches to the authors of a paper on international franchising. This paper does not attempt to cover them all, many of which have been covered in depth in previous papers and Forum publications. Instead, this paper is designed to serve as a warning or reminder of some of the "outliers" and to highlight some of the more unusual or surprising issues that a franchisor can encounter when franchising internationally.

We have focused on unique issues that are likely to impact the majority of franchisors. But note, this paper does not address issues specific to some industry sectors (such as automotive) or some structures used for franchising (such as joint ventures), which commonly face additional regulation. As such, the need to engage experienced local counsel to help navigate through the myriad issues cannot be overstated.

II. REGULATIONS APPLYING UPFRONT

A. Preliminary due diligence: Can we dance?

In today's legal environment, franchisors must perform due diligence to understand the unique legal challenges facing a business entering into a new territory. Due diligence traditionally covers fundamental issues relating to conducting business in-country, such as the ability to market the franchisor's products or services and use its brand, the impact of local franchise and other laws on the content and scope of the franchise offering, any barrier to enforcing the franchise agreement or to protecting its brand and (last but by no means least) any impediment to the franchisor getting paid. A summary of some of the fundamental questions a franchisor should ask before it commits resources to a possible franchise deal internationally is included as Attachment A to this paper.

It is equally important to understand the identity, background and relationships of the party with whom the franchisor is proposing to do business. Questions, such as who owns the prospective franchisee and who the prospective franchisee is related to, can be critical to understanding not only whether anti-corruption laws and sanctions regimes may impact the potential relationship, but also whether the franchisor itself may be in breach of such laws.

Moreover, the growth of these laws demands that companies conduct a basic level of due diligence. This topic is dealt with in more detail in section II.E below.

B. Is the location "franchisable"?

Once the due diligence has confirmed that the country permits franchising, a franchisor's sales team, more often than not, runs into the market to grow the brand. However, that may not be the only step required to inquire about the viability of growth in that geographical area. In Indonesia, the Ministry of Industry¹ regulates the places at which some franchised units may be operated (whether in a traditional market or in a modern shopping mall). Such a restrictive approach can originate from a government's desire to protect smaller local enterprises; as you will see elsewhere in this paper, particularly with respect to Indonesia.

C. Do foreign investment laws impact franchising itself?

In addition to restrictions on ownership or control of a local entity or business (which primarily impact joint ventures), franchising into certain countries can encounter barriers or hurdles imposed through local foreign investment regulation. In non-joint venture franchising, the issue is most frequently encountered when a franchisor is considering its options following the termination of a franchisee and may wish to operate the business itself on an interim basis.

One example of this is in Indonesia, which imposes severe restrictions on activities in certain business sectors being undertaken by foreign entities.² Foreign entities may not carry out retail businesses, except through large scale hypermarket businesses and the distribution sector is closed to foreign investors across all industry sectors.³

Another example is the Malaysian⁴ Guidelines on Foreign Participation in the Distributive Trade Services,⁵ which require that all proposals for foreign involvement in distributive trade (including local franchising) must first be approved by the Committee on Distributive Trade of the Ministry of Domestic Trade, Co-operatives and Consumerism and prohibit foreign investment in certain sectors, such as supermarkets of less than 3,000m², 24-hour convenience stores, bistros and jewelry shops. These approval obligations extend to

¹ Government Regulation No. 42 of 2007 on Franchising, and its implementing regulation, Minister of Trade Regulation No. 53/M-DAG/PER/8/2012, Minister of Trade Regulation No. 07/M-DAG/PER/2/2013 on Partnership Development in Franchise for Foods and Beverages Services Business Type, and Minister of Trade Regulation No. 68/M-DAG/PER/10/2012 on Franchise for Modern Store Business Type (Indon.).

² Capital Investment Law No. 25, art. 12, 2007 (Indon.).

³ List of Business Fields Closed to Investment and Business Fields Open, with Conditions, to Investment, Presidential Reg. No. 36 of 2010, app. II (Indon.).

⁴ See Foreign Investment Committee (FIC) Guidelines, Institut Bank-Bank Malay., ch. 6, *available at* http://www.ibbm.org.my/v3/wp-content/uploads/2013/03/Chap-6-amended-010305_2205t060205.pdf.

⁵ Guidelines on Foreign Participation in the Distributive Trade Services Malay. (Amendment 2010) (promulgated by the Ministry of Domestic Trade Co-Operatives and Consumerism) (hereinafter "Malaysian Guidelines").

opening new units, relocating or expanding existing units or outlets, buying or taking over other operators' outlets and purchasing land, premises or assets.⁶ The Committee requires all distributive trade companies with foreign equity, including franchisees, to appoint Bumiputera (native Malaysians) as directors,⁷ to formulate plans to assist Bumiputera participation and to hire personnel at all levels to reflect the racial composition of the Malaysian population.⁸ It should also be noted that the Guidelines require all local franchise businesses with foreign equity to be incorporated in Malaysia⁹ and that such companies must apply to the Distributive Trade Commission before obtaining approval from the Registrar of Franchises.¹⁰

In Saudi Arabia, the foreign investment climate is improving but still contains some hazards. The Saudi Foreign Investment Law governs foreign investors looking to invest in Saudi Arabia.¹¹ Under the new law and its related regulations, foreign investment (*i.e.*, investment by nationals of states outside the GCC) is permitted across all sectors of the economy, save for those on the "negative list."¹² The "negative list" identifies fully restricted and partially restricted activities.¹³ Not surprisingly, the "negative list" specifically prohibits foreign investment in real estate located in the cities of Mecca and Medina and activities related to the Hajj pilgrimage.¹⁴

An option to purchase the assets of a franchisee can sometimes be problematic, even if the franchisor does not propose to itself conduct business in country but only wishes to secure the assets for a successor master franchisee. A good example of this is Vietnam, which does

⁶ *Id.* at 3.

⁷ The requirement for 30% equity for Bumiputera was removed in 2010 and now only applies to hypermarkets (5,000m² or more). *Id.* at 5.

⁸ Malaysian Guidelines at 3.

⁹ *Id.* at 18.

¹⁰ *Id.* at 21.

¹¹ Royal Decree No. M/1 dated 5/1/1421H (corresponding to 10/4/2000G); See also Oxford Business Group, *Open for investment: Regulations relating to foreign investors; The Report: Saudi Arabia 2013*, <http://www.oxfordbusinessgroup.com/news/open-investment-regulations-relating-foreign-investors>.

¹² Oxford Business Group, *Open for investment: Regulations relating to foreign investors; The Report: Saudi Arabia 2013*, <http://www.oxfordbusinessgroup.com/news/open-investment-regulations-relating-foreign-investors>.

¹³ Saudi Arabia, 2013/2014 *Discovering Business* (Allurentis Ltd. 2013), <http://www.allurentis.com/publications/saudi-arabia-2013>. Fully restricted activities include oil exploration, oil production, manufacture of military equipment production of explosives, real estate brokerage services, real estate investments in Mecca and Medina, and Hajj pilgrimage. Partially restricted activities include wholesale, commercial agency and retail trade which may be licensed under special terms and subject to specific percentages of national participation and other policies or restrictions SAGIA establishes.

¹⁴ *Id.*

not allow a foreign business entity to sell goods locally, only to buy them for export on a limited basis, and also bans outright the export of products such as used consumer products or used IT products.¹⁵ The same Vietnamese law also bans a foreign business entity from conducting a wholesale or retail business in Vietnam¹⁶ and severely limits the opportunities of foreign-owned local entities to operate in the retail sector.

D. Experience may be required

In some cases, there may be pre-requisites to be fulfilled before a franchisor or its master franchisee is permitted to grant franchises in a particular country. This can prevent the business commencing in a country at all, and may also limit the local master franchisee's ability to comply with an aggressive development schedule.

In China, the now-famous "2+1 rule" applies, which means that the franchisor "group" must have owned and have operated at least two units under the format and brand for at least one year before applying for the right to franchise in the PRC. This requirement can be satisfied with company-owned operations in China, the franchisor's home country, or elsewhere in the world.¹⁷ There may be some flexibility around whether the experience needs to be that of the franchisor, its parent or an entity the franchisor controls, and whether it can include sister companies also controlled by the franchisor's parent entity. Of course the same rules also apply to the Chinese master franchisee. The franchisor's experience and satisfaction of the 2+1 rule does not extend to the local Chinese master franchisee. Therefore, a master franchisee must apply for permission to grant subfranchises in its own name; accordingly, the master franchisee must prove that it has operated two of its own "company-owned" (sometimes referred to as "direct-owned") units for one year each in order to be approved to grant subfranchises.

The Indonesian franchise law requires the franchisor to have been operating the particular franchised business for at least five years profitably.¹⁸ The Indonesian law also requires an in-country franchisor to operate and maintain at least one company-owned operation as a pre-condition for subfranchising.¹⁹

In Malaysia, the Registrar of Franchises must register a franchise before that business can, in turn, operate or subfranchise. The Registrar has broad discretion to impose conditions

¹⁵ Decree No. 90/2007/ND-CP, Decree No. 12/2006/ND-CP (Vietnam).

¹⁶ Ministry of Trade Decision No.10/2007/QD-BTM (Vietnam).

¹⁷ Regulations on Administration of Commercial Franchise (promulgated by the State Council, Feb. 6, 2007, effective May 1, 2007), art. 7 (P.R.C.). In 2011, amendments to the Regulations were proposed; among other things, these changes would have included an important relaxation of the 2+1 rule for hotel companies. The proposed amendment would have permitted hotel companies to satisfy the 2+1 rule by demonstrating proof of two company-*managed* hotel properties for one year each, in place of having to prove compliance by company-owned hotel properties. However, that proposed revision was not adopted as part of the 2012 amendment to the Regulation.

¹⁸ Gov't Reg. No. 42/2007, art. 3(b) (Indon.).

¹⁹ Gov't Reg. No. 42/2007, art. 6(2) (Indon.).

on the registration.²⁰ The current policy of the Malaysian franchise authorities is that a master franchisee must have been operating its “direct-owned” franchised businesses for at least three years before that master franchisee is permitted to appoint subfranchisees.²¹

To establish a franchise system in Vietnam, the franchise must have been operating for at least one year, but, more problematically, the local Vietnamese master franchisee must have itself operated the franchise in Vietnam for at least one year before it can commence subfranchising.²²

These requirements that an in-country master franchisee should be experienced before subfranchising sound sensible in theory, but the obligation can create a practical barrier to appointing a substitute master franchisee to assume subfranchise agreements, if the master franchisee fails or is terminated.

Elsewhere, national franchise association codes of ethics or membership rules commonly require a franchisor to be “experienced” before they embark on franchising, but these will only apply to a foreign franchisor who elects to become a member.²³

E. Sanctions regimes and impact of “boycotts”

For decades, governments have issued restrictions regarding with whom and how their citizens can conduct business with citizens of other countries. Keeping up with the lists of myriad sanctions programs can be daunting. For example, the United Kingdom operates a number of financial sanctions programs based on actions taken by the United Nations, the European Union, or the UK itself because of human rights abuses, to exert political pressure or limit the funding of terrorists or terrorist acts. The U.K. Treasury list contains over 8,900 names of entities or individuals with whom U.K. parties are precluded from doing business.²⁴ These

²⁰ Franchise Act 1998 §§ 6, 7 and 8 (Malay.).

²¹ Franchise (Forms and Fees) Regs. 1999 Form 1: Disclosure Document Franchise System, para. 18.1 (Malay.). It will require audited accounts for the last 3 years before the master franchisee can be registered. *Id.*

²² Decree No. 35/2006/ND-CP, art. 5(1) (Vietnam).

²³ For example, the European Franchise Federation's European Code of Ethics for Franchising requires a franchisor to have operated a business concept with success for a “reasonable time” before franchising. See *generally* European Franchise Federation, *European Code of Ethics for Franchising* (2008), available at http://www.eff-franchise.com/IMG/article_PDF/article_a13.pdf. This has been adopted widely into local franchise association Codes of Ethics, including those of the British Franchise Association and the Danish Franchise Association. See *generally* British Franchise Association, *Franchising Code of Ethics*, <http://www.thebfa.org/about-bfa/code-of-ethics> (last visited July 24, 2014); Lasse Arffmann Søndergaard Christensen & Søren Høgh Thomsen, *Denmark – Recent Developments in Franchising*, 11 INT’L J. FRANCHISING L. No. 4, 10, 13 (2013).

²⁴ HM Treasury, Consolidated List Of Financial Sanctions Targets In The UK, <https://www.gov.uk/government/publications/financial-sanctions-consolidated-list-of-targets/consolidated-list-of-targets> (last visited July 15, 2014).

lists are updated frequently and require companies to utilize tools to ensure ongoing compliance.

The United States also maintains a very robust sanctions program. The Office of Foreign Asset Control (OFAC), an agency within the U.S. Treasury Department, administers the various U.S. sanctions programs targeting individuals, entities and countries, as well as the Specially Designated Nationals List which prohibit U.S. parties from doing business with individuals and entities on the list.²⁵ Currently, the U.S. has 26 sanction programs targeting specific countries (e.g., Burma, Cuba, Iran, and Syria), individuals (Former Liberian Regime of Charles Taylor Sanctions) and specific issues (Non-Proliferation Sanctions).²⁶ Most recently, the U.S. government issued targeted sanctions (Sectoral Sanctions) in response to Russia's purported annexation of Crimea and other political upheaval in the Ukraine.²⁷

Complying with these sanction and boycott regimes is further complicated when programs of different countries clash, leaving companies in a proverbial "Catch 22." This is particularly evident as it relates to U.S. companies trying to manage with the U.S. Cuban Asset Control Regulations²⁸ and laws, as well as U.S. laws addressing the Arab League Boycott of Israel.²⁹

The Sheraton Mexico City hotel faced this issue in 2006 when a Cuban delegation sought to stay at the hotel. The hotel cancelled the reservations for the Cuban delegation in order to comply with the U.S. Cuban embargo and avoid the relevant penalties.³⁰ However,

²⁵ OFAC Frequently Asked Questions and Answers, <http://www.treasury.gov/resource-center/faqs/Sanctions/Pages/answer.aspx> (last visited July 14, 2014).

²⁶ U.S. Treasury Dep't, Sanctions Programs and Country Information, <http://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx> (last visited July 17, 2014).

²⁷ Exec. Order No. 13662, 79 Fed. Reg. 16169 (Mar. 24, 2014). See also OFAC, Ukraine-related Sanctions; Publication of Executive Order 13662 Sectoral Sanctions Identifications List, <http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20140716.aspx> (last visited Aug. 13, 2014).

²⁸ The Cuban Assets Control Regulations, 15 C.F.R. Part 515, were issued in July 1963 under the Trading With the Enemy Act. Many of the relevant regulatory provisions were adopted into federal law under the "Helms-Burton Act" (formally, the Cuban Liberty and Democratic Solidarity (LIBERTAD) Act of 1996, 110 Stat. 785 (1996)).

²⁹ The U.S. anti-boycott laws include the 1977 amendments to the Export Administration Act and the Ribicoff Amendment to the 1976 Tax Reform Act. These laws discourage, and in some cases prohibit, U.S. parties from participating in or supporting foreign boycotts. 26 U.S.C. § 999. See, e.g., the Saudi Law on the Boycott of Israel ([Saudi Ministry of Commerce and Industry, http://www.mci.gov.sa/en/LawsRegulations/SystemsAndRegulations/ProvincelsraelSystem/Pages/28-2.aspx](http://www.mci.gov.sa/en/LawsRegulations/SystemsAndRegulations/ProvincelsraelSystem/Pages/28-2.aspx)).

³⁰ Violating the U.S. Cuban embargo can result in criminal fines of \$1,000,000 for corporations, \$250,000 for individuals and potential imprisonment for wilful violations. Civil fines can be up to a \$65,000 per violation. LexisNexis, WorldCompliance, *What is the OFAC List's Penalty?* <http://www.worldcompliance.com/en/resources/due-diligence-legislation/OFAC-guidelines/OFAC-penalties.aspx>.

Mexico responded by claiming that Sheraton's actions breached the nation's sovereignty and fined Sheraton the equivalent of U.S. \$112,000.³¹

In addition to the ever-changing nature of these sanctions programs, the boycotts themselves can be overlooked given the passing of time and the reduced impact of some of these programs because of globalization. However, the laws are as relevant and impactful to companies as they were when initially passed. The U.S. boycott laws in response to the Arab League boycott of Israel are a prime example.

In 1948, the Arab League initiated a boycott of goods and services from Israel, including non-Israelis who maintain economic relations with or who are perceived to support that nation. In response, the U.S. government passed a series of laws precluding U.S. companies from complying with the boycott, but also mandated reporting of any requests to participate in the boycott to U.S. Department of Commerce. Participation in the boycott includes:

- i. Agreements to refuse or actual refusal to do business with or in Israel or with blacklisted companies;
- ii. Agreements to discriminate or actual discrimination against another person based upon race, religion, sex, national origin, or nationality;
- iii. Agreements to furnish or actual furnishing of information about business relationships with or in Israel or with blacklisted companies; and/or
- iv. Agreements to furnish or actually furnishing of information about the race, religion, sex, national origin, or nationality of an individual.

Failure to comply with the U.S. anti-boycott legislation can result in a number of civil and criminal penalties against U.S. violators, including the loss of certain tax benefits.³²

F. Registered trademark as a pre-requisite

It should (but does not always) go without saying that a franchisor should ensure that its brand can be used without breaching a third party's intellectual property rights and that it has taken steps to protect its brand in a country before it grants a franchise. The fact that trade mark registration can be a lengthy process needs to be considered by the business development teams when planning ahead. This assumes even greater and more urgent importance in countries requiring local registration of a trademark or trademark property right before the franchise agreement may be signed by a local party. For example, Malaysia³³ and

³¹ Ioan Grillo, *Mexican Government Fines Sheraton Hotel*, BANDERASNEWS, Mar. 2006, <http://www.banderasnews.com/0603/nr-mariaisabelsheraton.htm>. Hilton, a UK entity, encountered the same problem when, in 2007, it cancelled reservations of a Cuban delegation for the Hilton Hotel in Oslo. Hilton called for U.S./U.K. discussions to resolve the conflict. Duncan Campbell, *Hilton Hotels Lift European Ban on Cubans*, THE GUARDIAN, Mar. 1, 2007, <http://www.theguardian.com/world/2007/mar/02/cuba.duncancampbell>.

³² To report a boycott request, U.S. parties must file Form 5713 with the Internal Revenue Service. (Reporting is required even if the U.S. party did not cooperate in the boycott request.)

³³ Franchise Act 1998, § 24 (Malay.).

Indonesia³⁴ require that a franchisor register its intellectual property rights. In other countries, such as Mexico, the franchisor must merely file a trademark application before licensing or franchising.³⁵

Trademark registration can be equally critical in other countries to ensure that the franchisees can remit payment. For example, as a practical matter, a franchisor must have a registered trademark because a Chinese remitting bank will not permit the franchisee to remit funds to a U.S. franchisor until the trademark license agreement is duly registered, which can only happen after the mark has been registered.³⁶ In Nigeria, the National Office for Technology Acquisition and Promotion (NOTAP) will not permit a franchisee to remit payments to a foreign franchisor with respect to the use of unregistered trademarks.³⁷ NOTAP will also require evidence of the registration in Nigeria of any other intellectual property right licensed under the agreement.³⁸ As further discussed below, in Russia a franchisor's trademarks must be registered before a franchise agreement can become enforceable.

G. Governmental Franchise Registration Requirements and Filings

Trademark registration is not the only concern for franchise companies with respect to government registration. Registration requirements can extend to cover all parties to a franchise agreement, a franchisor's presale disclosure document and/or the franchise agreement itself. And in some instances, even if registration is not required, registration may strengthen enforceability rights.

1. Pre-sale registration filings

Several countries require franchisors to register before offering and selling franchises in-country. For example, franchisors in China that are undertaking commercial franchise activities within one single province, autonomous region or municipality that is under the direct control of central government, must register with a local branch office of MOFCOM. Franchisors, whose commercial franchise activities span multiple provinces, autonomous regions, or municipalities, must register with MOFCOM.³⁹ In Malaysia, franchisors, master franchisees and franchisees of

³⁴ Minister of Trade Regulation No. 53/M-DAG/PER/8/2012, art. 2(1) (Indon.).

³⁵ See Ley de Protección a la Propiedad Industrial [L.P.C.] [Industrial Property Protection Law] art. 142, Diario Oficial de la Federación [D.O.], el 27 de Junio de 1991 (Mexico).

³⁶ ALEX AN ET AL., DISTRIBUTION IN CHINA – LEGAL ISSUES (Frank Schoneveld ed.) at 46 (2013), <http://www.mwechinalaw.com/uploads/doc/DistributioninChina-LegalIssues.pdf>.

³⁷ See Updated Requirements for the Registration of Technology Transfer Agreements, NOTAP, Ministry of Science and Technology – Nigeria (Mar. 1, 2012), <http://notap.gov.ng/content/updated-requirements-registration-technology-transfer-agreements>.

³⁸ *Id.* See also Uche Eweluka Ofodile, *Franchising Law in Nigeria*, 2013 NIG. INT'L FRANCHISE ASS'N NEWSLETTER, http://nigerianfranchise.org/images/NiFA_Newsletter_December_2013.pdf.

³⁹ Regulations on Administration of Commercial Franchise (promulgated by the State Council, Feb. 6, 2007, effective May 1, 2007), art. 8 (P.R.C.).

foreign franchisors must first obtain approval of the Registrar of Franchises before they can offer to sell or buy franchises.⁴⁰ In Spain, franchisors must register with the Franchise Registry within three months of undertaking activity there.⁴¹

In Indonesia, the disclosure document must be registered with the Ministry of Trade, following which the franchisor or subfranchisor will receive a franchise registration certificate (the “franchisor certificate”).⁴² An application form must be submitted with a notarized copy of the disclosure document.⁴³ A franchisor franchising in South Korea must register its “information disclosure statement” with the South Korean Fair Trade Commission (KTFC), as well as any revisions made to the disclosure statement.⁴⁴ Franchisors are not permitted to accept a deposit or other fees until registration has occurred.⁴⁵

2. Post-Sale registration filings

In some cases, although registration is not required before a franchise agreement is signed, registration will be required before an agreement can be enforced.

Russia requires registration of the franchise agreement with the Federal Service for Intellectual Property (Rospatent) for the agreement to be enforceable. As of 1 October 2014, the Russian law on franchising will be amended to require only a summary of the franchise agreement to be registered, instead of the full franchise agreement itself. If an agreement is not registered with Rospatent, then the consequence will be that franchisees cannot remit payment outside of Russia and, more importantly, the arrangement is deemed invalid.⁴⁶ The registration requirements apply to the initial agreement, as well as amendments and termination of the agreement.⁴⁷

In Brazil, franchisors must register cross-border franchising contracts with the Instituto Nacional da Proprieda Industrial (INPI) to enable remittance of royalties out of Brazil and allow franchisees to deduct such royalties as operational expenses for income tax purposes.⁴⁸ Under

⁴⁰ Franchise Act 1998, § 6 (Malay.).

⁴¹ Real Decreto [R.D.] [Royal Decree] No. 201/2010, of 26 Feb., Boletín Oficial del Estado [B.O.E. 2012, 63] [Official Gazette 2012, 63] (Spain).

⁴² Minister of Trade Regulation No. 53/M-DAG/PER/8/2012, arts. 9, 10 (Indon.).

⁴³ *Id.* art. 13.

⁴⁴ Fair Franchise Transactions Act No. 6704 of May 13, 2002 (as amended) (hereinafter “S. Korean Franchise Act”) art. 6 (S. Korea).

⁴⁵ *Id.* art. 7(3).

⁴⁶ Grazhdanskii Kodeks Rossiiskoi Federatsii [GK] [Civil Code] (hereinafter, “Russian GK”) art. 1028(2) (Russ.).

⁴⁷ Russian GK arts. 452, 1036.

⁴⁸ LUIZ HENRIQUE O. DO AMARAL ET AL., INTERNATIONAL FRANCHISE SALES LAWS, BRAZIL 17 (Andrew P. Loewinger & Michael K. Lindsey eds., ABA Publishing 2011); see also LUIZ HENRIQUE O. DO AMARAL ET AL., *Guidelines*

the Industrial Property Law, INPI has 30 days to review the registration request and render a final decision.⁴⁹ After INPI approval, the franchise agreement must be registered with the Central Bank so that franchisees may remit royalties out of Brazil.⁵⁰

In each case where registration is required, franchisors should be mindful of delays this may cause. For example, in South Korea, although the legislation suggests that the KFTC should issue the registration certificate within 30 days,⁵¹ in practice, registration can take 90 to 120 days.⁵² In Brazil, the registration process currently takes 45 to 70 days. In China, the process can take a short period of time, but 3 to 6 months is not unheard of, especially during periods of crackdowns on official corruption.

In addition to being required, recording a summary of the franchise agreement in Mexico with the Instituto Mexicano de la Propiedad Industrial (IMPI) helps to enable the franchisor to bring a claim against third-party infringers and helps the franchisor enforce the agreement when it expires or if it is terminated.⁵³

Argentina is another example of this proposition; in Argentina, registration of a franchise agreement with the Argentine Transfer of Technology Authority is advisable to reduce tax withholding rates and to provide the franchisee with certain tax deductions. Compliance with local filing (and other procedural) requirements may also be helpful to a franchisor seeking to claim the benefit of a reduced withholding rate under a double taxation treaty between the target country and the franchisor's home nation.⁵⁴

Regardless of what any franchisor is registering with the government agency, one must ascertain whether there is a real need to register the documents and be alert that many of these countries requiring registration will carefully review the documents for specific provisions and to

for Recordal of Franchise Agreements in Brazil, 2011 Braz. Franchise Ass'n, http://www.franchise.org/uploadedFiles/GuidelinesFranchiseAgreements_January%202011.pdf.

⁴⁹ LUIZ HENRIQUE O. DO AMARAL ET AL., *INTERNATIONAL FRANCHISE SALES LAWS, BRAZIL 17* (Andrew P. Loewinger & Michael K. Lindsey eds., ABA Publishing 2011).

⁵⁰ *Id.*

⁵¹ Presidential Decree No. 17773, Enforcement Decree of the Fair Franchise Transactions Act (2002) (as amended Jan. 31, 2008), art. 5-2 (S. Korea).

⁵² Jae-Hoon Kim, Presentation at the IBA/IFA 30th Annual Joint Conference, Chicago: News from around the World, (May 2014).

⁵³ See L.P.C. [Industrial Property Protection Law] art. 179, D.O., el 27 de Junio de 1991 (Mexico).

⁵⁴ For a list of U.S. double taxation treaties, see I.R.S., *United States Income Tax Treaties - A to Z*, <http://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties---A-to-Z>. See also *supra* note 44.

understand the transactions.⁵⁵ In some cases, it may be advantageous to meet with the local agency to explain the documentation.

H. Unusual agreement requirements

1. Required Term of Agreement

It would be an unusual franchisor that seeks to enter into a short-term master franchise or franchise agreement, although that can be a factor in trial agreements. Some of these minimums make sense both for the franchisee and franchisor by allowing the franchisee time to establish itself in the market. For planning purposes, it is therefore important to note that several jurisdictions require a minimum term and that others require the term to be sufficiently long to enable the franchisee to recoup its investment.

Malaysia requires that an agreement be a minimum term of five years⁵⁶ and China three years.⁵⁷ Moreover, the Malaysian registry has taken the position that a master franchisee with a term of less than 5 years remaining on its master franchise agreement cannot subfranchise. While Indonesia no longer requires a minimum franchise term, as the franchise registration is for 5 years, granting a shorter term is not advisable. This is because a former franchisee having a still valid franchise registration may be able to block the registration of the new franchisee at the Ministry of Trade.

Other countries provide more opaque guidance on the length of term. Italy requires that the term must be sufficient to allow amortization of the investment, but in any event not less than three years.⁵⁸ While in Germany, the term must be "reasonable."⁵⁹

Conversely, a maximum rather than a minimum term in rare cases may be encountered. In Nigeria, NOTAP⁶⁰ as a practical matter often will provide approval for only a three-year period, after which the agreement may be renewed. In addition, NOTAP has the discretion to

⁵⁵ Section 5(2) of the NOTAP Act sets out the standards that agreements must meet in order to be registerable, although NOTAP has the authority to waive those requirements as it sees fit. In determining whether to register an agreement, NOTAP is also guided by the Revised Guidelines on the Acquisition of Foreign Technology. Decree No. 70 of 1979 (as amended by Decree No. 82 of 1992) cap 268 LFN (2002) (Nig.).

⁵⁶ Franchise Act 1998, § 25 (Malay.).

⁵⁷ Regulations on Administration of Commercial Franchise (promulgated by the State Council, Feb. 6, 2007, effective May 1, 2007), art. 13 (P.R.C.).

⁵⁸ ALDO FRIGNANI & GIUSEPPE "JOE" TOMASETTI, INTERNATIONAL FRANCHISE SALES LAWS, ITALY 19 (Andrew P. Loewinger & Michael K. Lindsey eds., ABA Publishing 2011).

⁵⁹ Bürgerliches Gesetzbuch [BGB] [Civil Code] Aug. 18, 1896, Reichsgesetzblatt [RGBI] as amended, § 307, ¶ 1 (F.R.G.).

⁶⁰ NOTAP Act (1994) cap. 268 LFN, § 6(l), (Nig.).

permit or deny those renewals, and may not permit the same level of royalty fees upon renewal.⁶¹

2. Language restraints

Companies doing business internationally may provide bilingual agreements for many reasons including franchisee requests; ease of use in countries where there is a high frequency of deal making; and, in a number of countries, legal requirements. While there are not a large number of countries requiring the use of foreign language franchise agreements, there are some such as Vietnam.⁶² Others, such as Italy, require a translation when requested by a franchisee.⁶³

But translations are more typically required when, either formally or as a matter of practice, filings need to be made with government offices. In Mexico, for example, the IPL does not require disclosure documents and franchise agreements translated; but, the summary of the franchise agreement recorded with the IMPI must be in Spanish.⁶⁴ South Korea also requires that all documents submitted for registration purposes including the template franchise agreement must be in Korean.⁶⁵ Indonesia requires the franchise agreement and the disclosure document be translated into Indonesian for the purposes of registration.⁶⁶ This is also the case in Brazil,⁶⁷ Russia,⁶⁸ and China⁶⁹ where local language copies of documents are required for filing purposes as a practical matter.

Franchisors should be mindful that in some cases, a requirement to translate into the local language will be imposed if it joins the local franchise association.⁷⁰ In other cases, although the agreement need not to be initially translated into the local language, if a dispute is heard before a local court, a translation would likely be required.

⁶¹ NOTAP; Uche Eweluka Ofodile, *Franchising Law in Nigeria*, 2013 NIG. INT'L. FRANCHISE ASS'N NEWSLETTER 3, available at http://www.nigerianfranchise.org/images/NiFA_Newsletter_December_2013.pdf.

⁶² Decree No. 35/2006/ND-CP, art. 12 (Vietnam).

⁶³ Gazzetta Ufficiale della Repubblica Italiana [Gazz. Uff.] [Official Gazette] no. 120 del 24 Maggio 2004, Legge 6 Maggio 2004, n. 129, art. 3(1) (Italy).

⁶⁴ L.P.C. [Industrial Property Protection Law] art. 179, D.O., el 27 de Junio de 1991 (Mexico).

⁶⁵ BRENDON CARR & JAE-HOON KIM, *INTERNATIONAL FRANCHISE SALES LAWS, S. KOREA* 19 (Andrew P. Loewinger & Michael K. Lindsey eds., ABA Publishing 2011).

⁶⁶ Minister of Trade Regulation No. 53/M-DAG/PER/8/2012, art. 5(4) (Indon.).

⁶⁷ Código Civil [C.C.] [Civil Code] art. 224 (Braz.).

⁶⁸ See Russian GK art. 1490.

⁶⁹ YU QIN & RICHARD L. WAGEMAN, *INTERNATIONAL FRANCHISE SALES LAWS, CHINA* 16 (Andrew P. Loewinger & Michael K. Lindsey eds., ABA Publishing 2011).

⁷⁰ European Code of Ethics for Franchising, European Franchise Federation, Sept. 19, 2003, art. 5.2.

3. Required governing law and venue

Although governing law and the type and venue of dispute resolution may not be deal-breakers for the business teams, a franchisor that concedes on these points may rue its decision once litigation ensues. While many countries grant parties the freedom of contract (including designating governing law, the form of dispute resolution, and venue), some jurisdictions will apply local law to interpret the contract or to enforce the franchise law, or a local venue, regardless of the parties' selection.⁷¹

It is invariably the case that parties to a franchise agreement cannot avoid the application of local franchise or other general law statutes or the application of local public policy. Any attempt to contract out such laws will be ineffective. In some cases, the local statute goes so far as to specify that any attempt to do so will be void.⁷²

In some limited countries, the local franchise law requires that local law be specified to be the law governing the contract itself, such as in Indonesia.⁷³ In other instances, general contract law, and not franchise law, may influence or require that local law govern the contract; as is the case in the Philippines.⁷⁴

Choice of venue is another matter. Before going into battle on this point, franchisors should ensure that a victory on this important detail will not be moot. A number of countries require all disputes relating to the contract to be heard in the courts of the jurisdiction in which the franchisee is located, or render void any attempt to oust the local jurisdiction; such as in the Philippines.⁷⁵ In other cases, a distinction is drawn between disputes relating to matters regulated by the franchise law, which must be heard at a local venue, and other contractual disputes which need not be. The Canadian provinces of Alberta, Ontario, Prince Edward Island, New Brunswick and Manitoba void any jurisdiction or venue clause that places the forum outside the specific province with regard to any claim that is otherwise enforceable under the franchise law of that province.⁷⁶

⁷¹ See, e.g., Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c. 3, sched. 10 (Ont.); Section 4 of the Illinois Franchise Disclosure Act of 1987 (as amended), 815 Ill. Comp. Stat. § 705/4.

⁷² See, e.g., Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c. 3, sched. 10 (Ont.).

⁷³ Minister of Trade Regulation No. 53/M-DAG/PER/8/2012, art. 5(1) (Indon.).

⁷⁴ An Act prescribing the Intellectual Property Code, Rep. Act No. 8293, § 88.1 (1997) (Phil.).

⁷⁵ *Id.*

⁷⁶ Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c 3, sched. 10 (Ont.); LARRY WEINBERG & FRANK ZAID, INTERNATIONAL FRANCHISE SALES LAWS, ONTARIO, CANADA 47 (Andrew P. Loewinger & Michael K. Lindsey eds. ABA Publishing 2011).

In Indonesia, the victory on including a foreign jurisdiction may be pyrrhic for a different reason. Although a foreign venue is not prohibited in Indonesia, foreign proceedings will not ultimately assist the franchisor, as foreign judgments will not be enforced there.⁷⁷

4. Restrictions on franchisee fees

Governments seldom get involved in the fees owed to franchisors under the license agreement. So it is unusual to franchising companies when they are advised that fees are capped. In Brazil, although the law does not distinguish franchise transactions, there is a cap of 5% on the remittance of royalties (for trademark, patent and technology transfer), from a Brazilian company to a foreign company.⁷⁸ South Africa also restricts fees to about 4-6% in certain consumer industries.⁷⁹ In Nigeria, royalty fees cannot exceed 5% of gross revenues, although in reviewing applications, NOTAP may actually only permit fees lower than that to be approved.⁸⁰

5. Obligation to provide a Protected Territory

The designation of protected territories in franchise agreements is traditionally a heavily negotiated subject between the franchisor seeking to grow its business and the franchisee (seeking to protect its business, particularly during its infancy). In South Korea, the government takes the position that each franchise agreement, after 14 August 2014, must contain a “business territory” within which a franchisor may not establish another franchised business for the same type of business.⁸¹ From a practical standpoint, providing some form of protected territory is encouraged to limit franchisees’ claims that the other parties’ local expansion under the brand is hindering their business and causing losses.⁸²

⁷⁷ Karen Mills & Ilman Rakhmat, *Arbitration Guide: Indonesia*, INT’L BAR ASS’N ARB. COMM. ARB. GUIDE, 2013, at 1, 20; see also Section IV.C.1 *infra* on enforcement rights and remedies, especially as to arbitration proceedings.

⁷⁸ Luiz Henrique O. Do Amaral et al., *The Guidelines for Recordal of Franchise Agreements in Brazil*, 2011 BRAZ. FRANCHISE ASS’N 5, http://www.franchise.org/uploadedFiles/GuidelinesFranchiseAgreements_January%202011.pdf “[R]oyalties involving related companies (such as parent and subsidiary) are limited by the corresponding ceiling of fiscal deductibility specified by Regulation no. 436/58, which vary between 1 to 5% of the net sales price depending on the field of activity involved.); see also, DOING BUSINESS IN BRAZIL 20, Ernst & Young Turco 2011, available at [http://www.ey.com/Publication/vwLUAssets/Doing_business_in_Brazil_2011/\\$FILE/Doing%20Business%20in%20Brazil%202011.pdf](http://www.ey.com/Publication/vwLUAssets/Doing_business_in_Brazil_2011/$FILE/Doing%20Business%20in%20Brazil%202011.pdf).

⁷⁹ South Africa Reserve Bank, Exchange Control Manual, <https://www.resbank.co.za/RegulationAndSupervision/FinancialSurveillanceAndExchangeControl/EXCMan/Section%20I/Section%20I.pdf> (last visited Aug. 13, 2014).

⁸⁰ Babette Marzheuser Wood, *Franchising in Africa: Opportunities and Challenges*, 17 FRANCHISE LAW. No. 2, at 7-9 (Spring 2014).

⁸¹ Fair Franchise Transactions Act (amended 13 Aug. 2013), art. 12-4 (S. Korea).

⁸² For more information on this topic see Rocio Belda de Mergelina et al, *Encroachment Issues Around the World*, IBA/IFA 30th Annual Joint Conference (May 7, 2014).

6. Post-signing Cooling-off Rights

The implementation of international franchise deals can be complicated by "buyer's remorse" provisions in some local laws that give franchisees the right to back out of a concluded deal. In Australia, franchisees have 7 days after the earlier of signing an agreement or paying any amount under the agreement, to unilaterally terminate the agreement and receive a refund.⁸³ A similar cooling off right (for seven or more days) applies in Malaysia.⁸⁴ In China, a franchise agreement is required to include a right for the franchisee to rescind within a specified time, but the period can be agreed by the parties.⁸⁵

I. Unique Pre-contract Disclosure Obligations

It is no longer unusual for a country to have a pre-contractual disclosure requirement in franchising.⁸⁶ Whether requiring a set format or that a prescribed range of topics must be covered, home jurisdiction disclosure will always need to be adapted to fit local requirements. In addition, a franchisor should not assume that the absence of a local franchise law will mean that a disclosure obligation does not apply. Such an obligation will often arise under general law, particularly in civil law countries⁸⁷ or under statutes dealing with misleading conduct.⁸⁸

1. Market Study

While most franchise disclosure around the globe covers the same core areas, there are some countries that take the additional step of requiring the franchisor to provide a market study as part of its disclosure. Belgian law⁸⁹ requires that the disclosure document describe the general and local market for the franchised business. The market disclosure must include "history, current status and future prospects of the franchise network's market share." Similarly,

⁸³ The franchisor is entitled to retain an amount equal to its reasonable expenses if the requirement to pay those expenses, or their method of calculation, is set out in the agreement. Trade Practices (Industry Codes - Franchising) Regulations, 1998, Annexure 1, item 13A, clause 13 (Austl.).

⁸⁴ Franchise Act 1998, § 18(4) (Malay.).

⁸⁵ Regulation on the Administration of Commercial Franchises, 1 May 2007, Article 12 (P.R.C.).

⁸⁶ INTERNATIONAL FRANCHISE SALES LAWS (Andrew P. Loewinger & Michael K. Lindsey eds., ABA Publishing 2011).

⁸⁷ For example, the German common law principle of *culpa in contrahendo*, gives rise to a precontractual duty of disclosure. BABBETTE MARZHEUSER-WOOD, THE FRANCHISE LAW REVIEW, GERMANY (Mark Abell ed., Law Business Research Ltd. 1st ed. 2014).. In the Province of Quebec, contracting parties must disclose material facts. *FRANCHISING IN CANADA: A Guide for Franchisors and their Legal Counsel* 15, Davis LLP (Jan. 2012), available at <http://www.davis.ca/en/publication/franchising-in-canada-a-guide-for-franchisors-and-their-legal-counsel/>.

⁸⁸ Such as under the Competition and Consumer Act, 2010 (Cth), Schedule 2, section 18 (Austl.).

⁸⁹ Belgian Law on Pre-Contractual Information regarding Agreements to Form Commercial Business Relationship (the Law of 19 December 2005).

the French *Loi Doubin*⁹⁰ requires franchisors to include “the state and prospects of the market (generally and locally).” Practically speaking, franchisors must be well-prepared to enter into these markets in order to gather the requisite market information.

2. Infrastructure Cost

Under recent changes to franchise legislation in South Korea,⁹¹ franchisors' ability to require their franchisees to remodel is now restricted to cases relating to hygiene or safety issues or where they are objectively in a state of deterioration. Importantly, whether or not the franchisor required the changes to be made, if the remodelling is directly related to brand image or value, such as changes to signage or interior design, so long as the change was recommended or required by the franchisor, the franchisor will be required to bear up to 40% of the costs. The only exception to this cost-sharing requirement will be where the changes are unavoidable due to acts of the franchise or health and safety issues.

Currently, the Australian "Franchising Code" requires franchisors to disclose whether a franchisee may be required to undertake significant expenditure that was not disclosed before they entered into the franchise agreement.⁹² Exposure draft changes to the Australian "Franchising Code,"⁹³ if implemented, will prohibit a franchisor from requiring a franchisee to undertake "significant capital expenditure" unless it was disclosed to the franchisee in the disclosure document, it was an expenditure incurred by a majority of franchisees and approved by them, it was incurred by the franchisee to comply with a legal obligation, it was agreed by the franchisee or it is an expenditure that the franchisor considers "necessary" as capital investment in the franchised business. Such expenditure will only be permitted as "necessary" if the franchisor justifies the expenditure in a statement providing the rationale for making the investment, the amount required, the anticipated outcome and benefits and the expected risks associated with making the investment.

3. Multi-layered disclosure

Also in Australia, foreign franchisors and other franchisors engaged in subfranchising have been subjected to multi-layered disclosure, under which franchisors and their master franchisees are required to provide a separate disclosure document to the master franchisee's subfranchisees.⁹⁴ The alternative of joint disclosure by the franchisor and the master franchisee is universally avoided for liability reasons.

⁹⁰ Journal Officiel de la République Française [J.O.] [Official Gazette of France], Jan. 2, 1990, p. 9, art. 1: Law No. 89-1008 of December 31, 1989 relative to the development of commercial and trade enterprises and the improvement of their economic, legal and social environment (the "*Loi Doubin*").

⁹¹ Fair Franchise Transactions Act (amended 13 Aug. 2013), art. 12-2 (S. Korea).

⁹² Trade Practices (Industry Codes - Franchising) Regulations, 1998, Annexure 1, item 13A (Austl.).

⁹³ Aust'l Treas., 2014 Exposure Draft amendments to the Franchising Code of Conduct, http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Franchising-Code_ (Austl.).

⁹⁴ Trade Practices (Industry Codes - Franchising) Regulations 1998, clause 6B(2) (Austl.). However, it is anticipated that changes to Australia's "Franchising Code" will mean that disclosure to subfranchisees in

4. Anticipated Revenue

Franchising counsel will commonly caution against a franchisor providing financial performance representations or earnings claims. Some countries do, unfortunately, require franchisors to confront this task. One example of this is Malaysia,⁹⁵ which requires a "financial forecast for three years" to be included in the franchise disclosure document. Other countries do not require such claims to be made, but mandate specific information to be given with them if they are provided.⁹⁶

A different and more restrictive approach has been taken in the recent changes in the South Korean legislation, in which franchisors will now be required to provide both minimum and maximum anticipated sales revenue for the first year of the franchise, together with an explanation of the calculation, at the time in which the franchise agreement is entered.⁹⁷ Interestingly, the maximum must not be more than three times the minimum figure.⁹⁸ Foreign franchisors will need to approach this formidable task with care and document carefully the due diligence steps have taken in calculating the projections. Under South Africa's Consumer Protection Act, franchisors must provide "written projections in respect of levels of potential sales, income, gross or net profits or other financial projections for the franchised business or franchises of a similar nature with particulars of the assumptions upon which these representations are made."⁹⁹

5. Lengthy disclosure and re-disclosure

U.S. franchisors are accustomed to disclosure periods that are more or less 14 business days prior to signing a franchise agreement or receiving an initial franchise fee. Internationally, the rules can be a little more onerous. Belgium and Mexico require franchisors to provide pre-sale disclosure materials one month prior to the signing of a franchise agreement.¹⁰⁰

relation to the franchisor and relevant elements of the master franchise agreement will be able to be provided by the master franchisee.

⁹⁵ Franchise (Forms and Fees) Regs. 1999, Form 1: Disclosure Document Franchise System, para. 18.2 (Malay.).

⁹⁶ An example of this is Australia which includes both historical and future financial details as "earnings information" for this purpose: Trade Practices (Industry Codes - Franchising) Regulations 1998, Annexure 1, item 19.

⁹⁷ Fair Franchise Transactions Act (amended 13 Aug. 2013), art. 9(5) (S. Korea).

⁹⁸ Enforcement Decree to the Fair Franchise Transactions Act (S. Korea).

⁹⁹ Consumer Protection Act 68 of 2008 (CPA), Regulation (3) (S. Afr.).

¹⁰⁰ Belgian Law on pre-contractual information, Doc. 51/1687, art. 3; Article 184 of the Mexican Industrial Property Law.

Under the Australian "Franchising Code", franchisors must re-disclose to a franchisee if the agreement changes materially, due to the requirement that the franchise agreement attached to the disclosure document must be "in the form in which it is to be executed."¹⁰¹

J. Payment restrictions

Difficulties in accessing funds owed by a franchisee due to exchange control restrictions have reduced in recent years, but a number remain. Moreover, these restrictions can change quickly as a result of changes in political winds and can be of an official or an unofficial nature.

In Argentina, the default position is that transfers of foreign currency out of the country require Argentine Central Bank approval. Automatic approvals are given for some payments, and in most cases payments under franchise agreements should qualify for these. However, a number of additional de facto restrictions can be exercised by other government agencies, even if Argentine Central Bank authorisation is not required.

Similarly, China's foreign exchange control system used to require a franchisee to present the franchise agreement filed with MOFCOM (or its local agencies) and a tax certificate evidencing that the franchisee has fulfilled any obligation in respect of withholding tax. In 2013, the Chinese State Administration of Foreign Exchange and the State Administration of Taxation issued new requirements easing the tax certification requirements for foreign exchange.¹⁰² India's Foreign Exchange Management Act requires the franchisee payer's bank to obtain a certificate from the franchisee's auditors regarding the nature of the payment, the reason for payment, the tax withheld, and confirmation that the tax has been paid to the tax authorities. This can result in payment delays, but the delays should be able to be managed by an efficient and compliance-driven franchisee.

In Nigeria, NOTAP's approval of fees is usually based on its satisfaction that the price or consideration to be paid for technology is commensurate with the technology to be acquired.¹⁰³ NOTAP also sets a ceiling on the total amount of remittances which may be made during the subsistence of any single approval.¹⁰⁴ The franchisee will be unable to access the foreign

¹⁰¹ Trade Practices (Industry Codes - Franchising) Regulations 1998, clause 10(c) (Austl.). It is expected that upcoming changes to the Franchising Code will relax this requirement. See Aust'l Treas., 2014 Exposure Draft amendments to the Franchising Code of Conduct, <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Franchising-Code>.

¹⁰² See Leslie A. Pappas, *China's New Foreign Exchange Rules Waive Tax Clearance for Payroll Remittances*, INT'L TAX MONITOR, Aug. 21, 2013, reproduced with permission, Ecovis, <http://www.ecovis.com/focus-china/chinas-new-foreign-exchange-rules-waive-tax-clearance-for-payroll-remittances/>; *China Tax Alert: Tax Clearance Procedure for Certain Outbound Remittances Overhauled*, 16 CHINA TAX ALERT 1, 1-2 (KPMG, July 2013), available at <https://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Newsletters/ChinaAlerts/Documents/china-tax-alert-1307-16-Tax-clearance-procedure.pdf>.

¹⁰³ NOTAP Act (1994) cap. 268 LFN, § 6(b) (Nig.).

¹⁰⁴ KENDAL H. TYRE, JR., FRANCHISING IN AFRICA, LEGAL AND BUSINESS CONSIDERATIONS (Kendal H. Tyre, Jr. & Diana Vilmenay-Hammond eds., LexNoir Foundation 2012); Theo Emuwa & Bimbola Fowler-Ekar, Franchising in Nigeria, 186.

exchange market for the purpose of remitting payments under the subfranchise agreement if the subfranchise agreement is not registered with NOTAP.¹⁰⁵ This is because evidence of NOTAP registration is one of the supporting documents that a commercial bank would require.¹⁰⁶

Russian currency control regulations have been significantly simplified in recent years and can now be regarded as additional paperwork rather than as a real obstacle to transferring money. Foreign investments can usually be repaid without any problems. Nevertheless, these currency regulations must be taken into account because Russian commercial banks are still in charge of currency control when conducting money transfers on their clients' behalf, and much paperwork must be done before a transfer occurs from a currency control perspective.

South African businesses may make payments to non-residents through "Authorized Dealers." Applications for approval to make those payments must be supported by the agreement and if the payments are not evident in the agreement, "a clear explanation of how the values were arrived at must accompany the application."¹⁰⁷

K. Requirement to Pay a Stamp Tax on the Agreement

An assessment of the viability of a franchise into a new country will necessarily require consideration of the in-country tax treatment of payments required to be made to the franchisor. A tax impost in some countries that should be considered is stamp duty, or "stamp tax." Originally introduced in 17th Century England to fund wars against France, it remains a source of revenue in a number of countries. In Argentina, all documents with an economic value are subject to such a tax, at a rate of between 0.8% and 2.0%, depending on the province in which it is signed or has effect, and the franchisor and franchisee typically bear half each. In Turkey, the practice can be to assess the "value" of the agreement for stamp tax purposes by reference to the highest monetary amount specified in the agreement. Side letters or other measures can be lawfully taken to eliminate or minimise such taxes in some cases and should be explored.

L. Regulation of advertising fund contributions

Marketing funds are intended to promote the brand within the country and globally. The funds are typically treated as separate and apart from royalty fees and other fees paid to the franchisor. Unless required as part of the bylaws of a franchisee advisory or other franchisor/franchisee committee, these funds are seldom subject to audit. However, certain countries require franchisors to provide audited financial statements to their franchisees. In Malaysia, marketing or promotional funds are not only required to be kept in a separate account

¹⁰⁵ NOTAP Act (1994) cap. 268 LFN, § 7 (Nig.).

¹⁰⁶ KENDAL H. TYRE, JR., FRANCHISING IN AFRICA, LEGAL AND BUSINESS CONSIDERATIONS (Kendal H. Tyre, Jr. & Diana Vilmenay-Hammond eds., LexNoir Foundation 2012); Theo Emuwa & Bimbola Fowler-Ekar, Franchising in Nigeria, 191-92.

¹⁰⁷ South Africa Reserve Bank, Exchange Control Manual, <https://www.resbank.co.za/RegulationAndSupervision/FinancialSurveillanceAndExchangeControl/EXCMan/Section%20I/Section%20I.pdf> (last visited Aug. 13, 2014). The Minister of Finance appoints "Authorized Dealers," who are permitted to buy and sell foreign currency. *Id.*

and audited, the audit statement is required to be lodged annually with the Registrar of Franchises.¹⁰⁸

Australia has for some time required marketing or other cooperative funds into which a franchisee pays money to be audited on an annual basis, unless 75% of the franchisees in Australia agree, at least every three years, that an audit is not required.¹⁰⁹ However, draft changes to the Australian "Franchising Code" suggest that in future this vote will need to occur annually.¹¹⁰ Neither the current nor the draft amended Code limit this to a fund managed from within Australia.

III. REGULATIONS APPLYING THROUGHOUT THE RELATIONSHIP

A. Lots of Rules

If a franchisor focuses primarily on "getting the deal done" and the required content for its local franchise agreement and local disclosure, it may be later surprised by the type or frequency of ongoing compliance obligations it is not used to at home. We have highlighted below just a few of the compliance issues that may arise.

B. Local Industry Development Considerations

As we noted previously, Indonesia takes an unusual and paternalistic approach to industry development, seeking to use franchising as a tool to encourage and train small businesses, particularly in rural areas.

Indonesian law requires franchisees to "cooperate with" small and medium businesses in the local area as franchisees or as suppliers of goods or services and at least 80% of the raw materials, business equipment or merchandise to be used by a franchisee must be locally made.¹¹¹ Exemptions can be applied for at the time of registration with the Ministry of Trade, which will consider factors such as local availability and whether supply from small or medium enterprises is being encouraged. Notably, exemptions have been granted in the case of luxury goods franchises.

To encourage the development of local small to medium business, Indonesian franchise law limits the number of franchise outlets certain types of franchise businesses may have to 150 if a minimarket, supermarket, department store, hypermarket or wholesaler,¹¹² or to 250 if a

¹⁰⁸ Franchise Act 1998, § 22 (Malay.).

¹⁰⁹ Trade Practices (Industry Codes - Franchising) Regulations 1998, clause 17(1) and (2) (Austl.).

¹¹⁰ See Austl. Treas., 2014 Exposure Draft amendments to the Franchising Code of Conduct, <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Franchising-Code>.

¹¹¹ Minister of Trade Regulation No. 53/M-DAG/PER/8/2012, art. 19 (Indon.).

¹¹² Minister of Trade Regulation No. 68/M-DAG/PER/10/2012, art. 3 (Indon.).

restaurant, bar or cafe.¹¹³ To support this, the Indonesia law bans the grant of franchises to an entity directly or indirectly controlled by the franchisor.¹¹⁴

In Nigeria, the NOTAP Act prohibits the registration of any agreement for technology transfer where there is an obligation to acquire equipment, tools, parts or raw materials exclusively from the transferor (in this case the franchisor) or any other person or given source.¹¹⁵ This limitation – in effect depriving the franchisor of the ability to enforce sourcing restrictions, even for a product distribution franchise – can be fundamentally devastating to enforcing system standards and, in at least one case, led a franchisor to conclude that it could not, as a practical matter, offer franchises to operate in Nigeria.

NOTAP may take the view that it is sufficient for the subfranchisor to specify the standards to which the raw materials used for the restaurants must meet and give the franchisee the right to choose a supplier.

C. Restrictions on the acquisition or supply of products and services

1. Specifying suppliers

It is commonplace for a franchisor to want to protect certain elements of its franchise system whether it is the ice cream, the hamburger meat served or the vendor used to make and install the sign. But the franchisor's freedom to protect those elements can be prohibited in some jurisdictions and permitted in others if they are objectively justifiable. In Australia, requiring a franchisee to purchase only from a specified third party supplier, or a from a list of specified suppliers is prohibited, unless a notification of this "third line forcing" conduct is provided to the anti-trust regulator, which will provide immunity from the breach.¹¹⁶

South Korea requires franchisees to comply with quality standards required by the franchisor. However, South Korean franchise law prohibits a franchisor from unfairly requiring its franchisee to transact with a designated supplier, although the law provides exceptions if: (a) the products are essential for the management of the franchise business; (b) the products are needed to protect the franchisor's trademark rights or if it is difficult to do so without designating suppliers; and (c) the franchisor makes this known, ahead of time, in the disclosure document.¹¹⁷

¹¹³ Minister of Trade Regulation No. 07/M-DAG/PER/2/2013, art. 4 (Indon.).

¹¹⁴ Minister of Trade Regulation No. 53/M-DAG/PER/8/2012, art. 7 (Indon.).

¹¹⁵ NOTAP Act (1994) cap. 268 LFN, § 6(f) (Nigeria).

¹¹⁶ Competition and Consumer Act, 2010 (Cth) s 47(6) (Austl.).

¹¹⁷ BRENDON CARR & JAE-HOON KIM, INTERNATIONAL FRANCHISE SALES LAWS, S. KOREA 26 (Andrew P. Loewinger & Michael K. Lindsey eds., ABA Publishing 2011).

2. Restricting customers

For certain franchise systems, franchisors may try to limit a franchisee's ability to sell goods or render services only to a defined territory or to particular types of customers (for example, end-users rather than wholesalers or in-store, but not on-line). However, certain countries prohibit or limit this behavior. Importantly, the European Commission's "Verticals Regulation"¹¹⁸ may have the effect of prohibiting a franchisor from preventing a franchisee selling into a particular territory or to particular customers. However, it provides a limited exception to allow a franchisor to reserve to itself or to other franchisees the right to make "active" sales into an exclusive territory or to an exclusive customer group. The distinction between such permitted "active" sales and "passive" sales means that a franchisor in the EU cannot prohibit its franchisees from making sales using the internet.

Another example of a restriction is the Lithuanian Civil Code expressly nullifies and voids any franchise contract terms that would otherwise limit a franchisee to offering goods and services only to customers residing in their contractual territory.¹¹⁹ The Russian Civil Code bans franchise agreement clauses that would limit a franchisee's ability to sell goods or render services to customers outside of the protected territory.¹²⁰

D. Registration and the Ability to Change the Franchise Agreement or the Nature of the Franchise

In countries requiring registration of the franchise agreement or relationship, changes made to the franchise agreement or to the system as described in the registration documents may be restricted. The business registration certificate that franchisors file in Indonesia specifies the nature of the business. However, the certificate also serves to limit the business by permitting sales outside of the specified core business to no more than 10 percent of total sales¹²¹ In addition, in Russia, as previously noted, any amendments to a registered franchise agreement must also be registered with Rospatent.¹²²

Another example of a substantial registration requirement is found in South Korea. In South Korea, material changes to information in the registered disclosure documents of the franchisor¹²³ triggers a requirement to apply to the KFTC to register the change within 30 days

¹¹⁸ Commission Regulation 330/2010, art(s). 101(3), 2010 O.J. (L 102) 53 (EU).

¹¹⁹ L.C.C., art. 6.772.4 (Lith.).

¹²⁰ Russian GK art. 1033.

¹²¹ Minister of Trade Regulation No. 53/M-DAG/PER/8/2012, art. 21 (Indon.).

¹²² Russian GK arts. 452, 1036.

¹²³ Presidential Decree No. 17773, Enforcement Decree of the Fair Franchise Transactions Act (2002) (as amended Jan. 31, 2008), app. 1.2 (S. Korea).

of when the change occurred (within 30 days after the quarter during which the change occurred).¹²⁴

E. Continuous Disclosure Obligations

U.S. franchisors are accustomed to delivering a franchise disclosure document prior to executing a franchise deal. However, they may be unaware of an obligation, imposed in certain countries, to provide ongoing disclosure post execution of the franchise agreement. Some countries impose that requirement by stipulating, directly or indirectly, such an obligation upon franchisors. Others may, as a practical matter, impose that requirement in order to meet a general "fair dealing" obligation.¹²⁵

The Australian franchise law imposes an obligation on a franchisor to continuously disclose certain "materially relevant facts" to its franchisees for the duration of the franchise term. The obligation is limited to a list of specific items, such as changes in the majority ownership or control of the franchisor or its intellectual property or certain litigation proceedings in Australia. Disclosure must be provided in writing to franchisees within a reasonable time (but no more than 14 days) after the franchisor becomes aware of the change.¹²⁶ Unhelpfully, there is no exemption from the obligation to notify of changes in control of a listed public company.

The obligation to update disclosure documents on an annual basis has also been a burden for franchisors that are not actively franchising in Australia. The proposed changes to the Australian "Franchising Code" acknowledge and alleviate this, but only to a limited extent. An annual update will not be required, but only if the franchisor entered into only one franchise agreement during the previous year and does not intend to franchise in the following year. Strangely, this exclusion may not be applied more than once in any three-year period. As a result, it is likely that in practice most franchisors will be required to update their disclosure document in most years, even if not actively engaged in franchising.

In the case of South Korea, in addition to the obligation to notify the KFTC of changes, a franchisor must notify franchisees, via email or posting on franchisor's website, of any changes

¹²⁴ *Id.* art. 5-3.

¹²⁵ For example, in several provinces there is a debate as to whether the fair dealing obligation requires on-going disclosure. W. Brad Hanna et al., FRANCHISING AND DISTRIBUTION BULLETIN (Oct 2013), <http://www.mcmillan.ca/dealing-with-the-duty-of-good-faith-and-fair-dealing-in-franchise-agreements>. ("It will be easier for a franchisor to demonstrate it had due regard for the interests of franchisees if, prior to a franchisor implementing changes, franchisees are given information about the impact and an opportunity to provide feedback. Having a franchisee advisory committee composed of respected franchisees who are to communicate with other franchisees about prospective changes provides an effective alternative to dealing with all individual franchisees, particularly if the consultation process involves due consideration and adaptation, as appropriate, in response to committee feedback.")

¹²⁶ Trade Practices (Industry Codes-Franchising) Regulations 2014, clause 18, (Austl.).

to information contained in the disclosure documents within 7 days after the date of changes are registered with the KFTC.¹²⁷

The time limit on notification is less precise in China, which requires material change to the disclosed information, to be notified to franchisees "in a timely manner."¹²⁸

F. Ongoing regulatory filings

In addition to certain registrations and filings, franchisors must submit annual reports to certain government agencies detailing such things as number of franchises sold and terminated. Countries that require such annual reporting obligations include China and Malaysia.¹²⁹

In Malaysia the obligation is to submit a report to the Registrar of Franchises within six months of the end of each financial year of the franchise business containing, among other things, an updated disclosure document and audited financial statements.¹³⁰ In China, a report regarding franchise agreements concluded in the previous year must be filed in the first quarter of every year.¹³¹

G. Restrictions on opening hours

On rare occasions, a unique requirement is introduced into a country's franchise law to deal with a perceived local problem in a particular industry, or for local political reasons. One example of this is South Korea, where the convenience store sector has had its share of difficulties. The recent changes to the franchise law in South Korea included a law restricting the franchisor's ability to require the franchisee to engage in late night trading between 1 am and 7 am if the franchisee's costs of opening in that period have exceeded its sales in doing so in the previous 6 month period.¹³² This legislation would appear to be a response to a local concern and may create an ongoing obligation for a franchisor.

¹²⁷ Presidential Decree No. 17773, Enforcement Decree of the Fair Franchise Transactions Act (2002) (as amended Jan. 31, 2008), art. 5-3 (S. Korea); see also, BRENDON CARR & JAE-HOON KIM, INTERNATIONAL FRANCHISE SALES LAWS, S. KOREA 9 (Andrew P. Loewinger & Michael K. Lindsey eds., ABA Publishing 2011).

¹²⁸ Regulations on Administration of Commercial Franchise (promulgated by the State Council, Feb. 6, 2007, effective May 1, 2007), art. 23 (P.R.C.).

¹²⁹ In S. Korea, an annual filing is required within 100 days of the end of each business year. Presidential Decree No. 17773, Enforcement Decree of the Fair Franchise Transactions Act (2002) (as amended Jan. 31, 2008), app. 1.2 (S. Korea), Bus. Franchise Guide (CCH) ¶ 7170.

¹³⁰ Franchise Act 1998, § 16 (Malay.)

¹³¹ Regulations on Administration of Commercial Franchise (promulgated by the State Council, Feb. 6, 2007, effective May 1, 2007), art. 19 (P.R.C.).

¹³² Fair Franchise Act (amended 13 Aug. 2013), art. 12-3 (S. Korea).

H. Restrictions on the franchisor competing with the franchisee

Another example of the South Korean tendency to be highly protective of local franchisees is the new requirement that franchise agreements entered into in South Korea since 14 August 2014 that franchisors do not permit the franchisor to grant other franchises or itself operate franchise units in the same "industry" within the franchisee's territory. It appears that whether or not the business is in the same "industry" will be judged by reference to the products or services, the type of business and the manner in which it will be conducted.¹³³

I. Prohibition on collecting interest

The influence of Sharia law has risen over the last several years. Moreover, the breadth of Sharia law on contractual relationships as well as everyday life can be significant. The issue of interest on outstanding fees is one such area that Sharia law can influence a contract. In the federal Islamic state of the United Arab Emirates, interest is void and unenforceable. However, interest is permitted in commercial transactions¹³⁴ in the UAE: (i) if specified in a contract, at the rate agreed by the parties; or (ii) if not specified in the contract, at the rate of interest then prevailing in the market, but not in excess of 12% for commercial loans.¹³⁵ Therefore, subject to these constraints, courts in the UAE will enforce interest provisions in franchise agreements. Similarly, the Egyptian authorities have generally enforced provisions for interest in commercial transactions.¹³⁶ By contrast, in Saudi Arabia a requirement to pay interest will not be enforced, because there is no exception to the general prohibition on imposing interest under Sharia law.¹³⁷

J. Dry countries/food limitations

Local laws and customs may also impact whether a franchisee may serve alcohol and certain foods. Indonesia has specific laws impacting the importation of food, food registration and the distribution of 'halal' certificates.¹³⁸ Furthermore, Islamic law's strict prohibition or limitations on alcoholic beverages and pork can have a significant impact on a franchise

¹³³ *Id.* art. 12-4.

¹³⁴ Articles 76-78, 88 and 89 of UAE Federal Law No. 18 of 1993 regarding Commercial Transactions.

¹³⁵ *Id.* at art. 76.

¹³⁶ Law No. 131 of 1948 (Civil Code), *Al-Jarida Al-Rasmiyya*, 29 July 1948, §§ 226-28, 231-32 (Egypt).

¹³⁷ CLYDE & CO LLP, *DOING BUSINESS IN SAUDI ARABIA: LEGAL 1–2* (2013), <http://saudi-arabia.doingbusinessguide.co.uk/the-guide/legal/pdf>.

¹³⁸ USDA Foreign Agricultural Service, Global Agricultural Information Network, Indonesia, Gain Report No. ID1252 (Feb. 5, 2013), *available at* http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Food%20and%20Agricultural%20Import%20Regulations%20and%20Standards%20-%20Narrative_Jakarta_Indonesia_2-5-2013.pdf; Ministry of Trade Regulation No. 53/M-DAG/PER/8/2012 and Decree of the Director General of Domestic Trade No. 65/PDN/KEP/6/2014 on Implementation Guidelines on Local Content Requirement for Shopping Centers and Modern Stores.

business' revenue. For example, there is a strict prohibition on serving alcoholic beverages in Saudi Arabia and Egypt, and similar restrictions are enforced in Qatar. Similarly, pork products are prohibited in Saudi Arabia.¹³⁹ Other examples of these (and similar) limitations abound, both in law as well as commercial (and social) custom.¹⁴⁰

K. Environmental Regulations

Recently, a number of countries have imposed significant burdens on businesses relating to environmental protection schemes. Over and above general requirements (which typically apply to businesses of a particular size, with some exceptions), some regulations call out franchisors specifically to help implement, score, collect and pay fees associated with these regulations on behalf of their franchise group.

Australia's *National Greenhouse and Energy Reporting Act, 2007 (Cth)*, while limited to a reporting rather than a payment obligation, required an entity having "operational control" of another to report the energy use of that other entity.¹⁴¹ A number of franchise systems are considered to have such control for these purposes.

In 2010, the United Kingdom enacted a cap and trade scheme to reduce carbon emissions in the United Kingdom through the mechanism of the UK Carbon Emissions Fee (CRC Energy Efficiency Scheme) ("CRC").¹⁴² The UK law goes significantly further than the law in Australia, as it requires franchisors to be responsible for the energy use of its franchisees when determining qualification for and participation in the CRC program. Under the CRC, a franchise agreement is found where:

- i. an agreement exists between two organizations (the franchisee and the franchisor) for the sale or distribution of goods, or provision of services;
- ii. the franchisee carries out business using the name provided by the franchisor in the agreement;
- iii. the premises from which the franchisee carries out the franchised business are used exclusively for that business; and
- iv. the presentation of those premises must have an internal or external appearance agreed by the franchisor and must be similar to that of other premises operating a franchise business under an agreement with the franchisor.

¹³⁹ SHEHAB AL-FAKHRI, PORK IMPORT AND SAUDI ARABIA 3 (1999), <http://www1.american.edu/ted/saudpork.htm>

¹⁴⁰ See, e.g., Tripti Lahiri, *Can Restaurants in India Legally Serve Beef?*, WALL ST. J., May 21, 2012, available at <http://blogs.wsj.com/indiarealtime/2012/05/21/is-it-legal-for-restaurants-in-india-to-serve-beef/>.

¹⁴¹ <http://www.comlaw.gov.au/Series/C2007A00175>.

¹⁴² CRC Energy Efficiency Scheme Order 2010 (SI 2010/768) (CRC Order 2010), as amended by the CRC Order 2013 and the CRC Energy Efficiency Scheme (Amendment) Order 2011 (SI 2011/234).

As such, the franchisor is required to collect information concerning the energy use of its franchised and company-owned locations, prepare the submission and then pay a fee depending upon the amount of carbon emissions released. The difficulty for franchisors is that the government initially argued that that CRC Scheme is not a tax but a usage fee; a nuance which some franchisees have exploited to avoid reimbursing the franchisors for the CRC fee. However, subsequent statements by senior U.K. officials have acknowledged that the CRC fee has in turn evolved into a tax to fund the government. Despite these statements, the argument over whether franchisees must reimburse franchisors for the CRC fee continues.

In Ontario, Canada, franchisors may get caught in the grasp of the Ontario's Waste Diversion Act, 2002 ("WDA").¹⁴³ The WDA regulates the disposal of electrical and electronic equipment (EEE) from the waste stream into the recycling stream. The basic premise of the program is that fees are collected from "stewards" to offset the costs of diverting EEE from the waste stream into the recycling stream. Franchisors must be wary as the act specifically identifies franchisors as potential stewards for EEE it supplies to Ontario-based franchisees within the franchise system.¹⁴⁴ As a steward, a franchisor must (i) pay the established EEE fees; (ii) keep and provide records; and (iii) provide reports and other information as requested by the Ontario Electronic Stewardship (the Ontario agency responsible for administering the WDA).¹⁴⁵

The determination of who is the "steward" is based upon a hierarchy established by the OES.¹⁴⁶ As a practical matter, franchisors who acquire an EEE from a provider should ensure that the provider has an OES identification number. If the OES identification number is not provided, the person to whom a provider supplies the EEE will then be a steward and will be responsible for filing the steward report and paying the fees. The OES identification numbers are available from the OES.¹⁴⁷ If an environmental handling fee is not charged by a supplier on the invoice for an EEE, this is often an indication that no other steward exists in respect of the EEE.

From one author's experience, it appears in certain instances that the OES has chosen to initially pursue franchisors to pay the applicable fees for any EEE that has not been otherwise captured rather than go after individual businesses. This inquiry leads a significant amount of time and energy attempting to persuade the OES that a franchisor that is not directly supplying EEE to its franchisees has been wrongly targeted.

¹⁴³ http://www.e-laws.gov.on.ca/html/source/statutes/english/2002/elaws_src_s02006_e.htm.

¹⁴⁴ Ontario Electronic Stewardship, *2013 Rules for Stewards with Respect to Payment of EEE Fees*, http://www.ontarioelectronicstewardship.ca/sites/all/files/pdf/rules/rules_for_stewards_payment%20weee_fees%20mar4_13_signed.pdf.

¹⁴⁵ *Id.*

¹⁴⁶ *Id.*

¹⁴⁷ *Id.*

IV. REGULATIONS APPLYING ONCE THE RELATIONSHIP ENDS

A. Compensation under agency laws

Agency and distribution laws are ingrained in the culture of local trade and commerce and differ widely. Agency laws, in particular, can be paternalistic and highly protective of the agent, who is asked to assume risks on behalf of a principal. Agency laws are a particular feature of civil law countries and commonly provide the agent with a right to commission, to notice of termination and/or to compensation for termination. They tend to be limited to genuine agency relationships, which can be contrasted with a typical business format franchise.¹⁴⁸

The UAE Commercial Agency Law provides various statutory protections to registered commercial agents that can be problematic for a foreign franchisor. The UAE Ministry of Economy has substantial discretion to determine whether a relationship qualifies as a commercial agency based on relevant facts and circumstances.

A commercial agency relationship can generally be registered only if the foreign principal's signature on the agreement is duly authenticated and notarized. Accordingly, to reduce the likelihood of registration as a commercial agency, a franchisor may decide not to execute any of the agreements being notarized or otherwise authenticated. However, this is not the answer in all cases, as some courts in the UAE may seek to extend the rights afforded under the UAE Commercial Agency Law to both registered and unregistered commercial agency agreements in certain contexts.¹⁴⁹ This differs from treatment in the Dominican Republic¹⁵⁰ and Honduras, where a franchisee must first register the agreement in order to receive the protections of the respective agency law.¹⁵¹

¹⁴⁸ For example, the Russian Civil Code deals with both agents and franchises, but in separate provisions. Compare Russian GK art. 971 with art. 1027.

¹⁴⁹ If an agreement cannot be registered as a commercial agency in the UAE (e.g., if it is not translated into Arabic, notarized, and authenticated), then the UAE Commercial Transactions Law may be applied to a franchise relationship. Marcus Wallman, *Franchising in the UAE*, Al Tamimi & Co. Update (Oct-Nov 2011), <http://www.tamimi.com/en/magazine/law-update/section-7/october-november-1/franchising-in-the-uae.html>.

¹⁵⁰ The Dominican Republic statute, referred to as "Law 173," affords a distributor (or, arguably, a franchisee) rights akin to those of a commercial agency. Law 173 for the Protection of Agents, Importer of Merchandise and Products (1966) art. 10; however, as part of the 2004 US-Dominican Free Trade Agreement, the Dominican Republic agreed that contracts entered into by US parties with Dominican Republic parties, after that treaty took effect, would not apply Law No. 173 absent the parties' agreement to do so. Dominican Republic Central America-United States Free Trade Agreement, Annex 11.13, Section B (Aug. 5, 2004). Law 173 may still apply with respect to contracts entered into that are not covered by the United States' DR-CAFTA treaty.

¹⁵¹ Representation, Distribution and Agency of Foreign and National Principals Regulation, art. 12 (Honduras), which was limited with respect to new agreements between a US entity and a Honduran entity that were entered into after the DR-CAFTA treaty was signed in August 2004.

B. Enforceability of non-compete

Article 101 of 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.¹⁵² Vertical agreements where neither party holds a market share of more than 15%¹⁵³ in the EEA are presumed not to breach Article 101, so long as they do not contain any "hardcore" restraints. In addition, the European Commission presumes that a vertical agreement has no appreciable effect on trade between Member States if the aggregate market share of the parties in any relevant market within the EEA affected by the agreement does not exceed 5% and the aggregated turnover of the supplier does not exceed €40 million.¹⁵⁴ If an agreement reaches a relevant market share threshold, then any anti-competitive restriction contained in the agreement will be void and unenforceable in the national courts of any Member State, unless subject to a specific exemption. One of the exemptions granted by the European Commission is the "Verticals Regulation."¹⁵⁵

Non-compete obligations which do not benefit from the protection of the Verticals Regulation will be unenforceable, but may be severed from the rest of the agreement. The only non-compete obligations which benefit from the protection of the regulation are those having a term of no more than 5 years (including renewals). In respect of post-term non-compete obligations, the only excluded non-compete obligations are those which are limited to the premises and land from which the franchisee has operated during the contract period, the goods or services it purchased, which are indispensable to protect the know-how of the franchisor and which are limited to a period of one year after termination of the agreement. It is also important to note that an indirect restraint created by an obligation to source 80% or more of its total purchases of goods or services from the supplier, will be treated as a non-compete obligation for this purpose. The good news is that in a selective distribution system, such as a franchise system, any direct or indirect obligation imposed on distributors not to sell a competing brand will be permitted.

C. Enforcement Rights and Remedies

1. Theory versus Practice

The ability of a franchisor to enforce the rights provided in a franchise agreement should be considered in the context of each negotiation. These considerations should include whether

¹⁵² Treaty of the Functioning of the European Union, art. 101, 2012 O.J. (C 326) 50.

¹⁵³ European Commission's Notice on Agreements of Minor Importance 22 December 2001, O.J. C2001/C 368/07.

¹⁵⁴ European Commission Guidelines on the Effect on Trade Concept contained in Articles 81 and 82 of the Treaty, O.J. C2004 101/81.

¹⁵⁵ Commission Regulation (EU) No. 330/2010 of 20 April 2010 on the application of Article 101(3) of the Treaty of the Functioning of the European Union to categories of vertical agreements and concerted practices.

arbitration is preferable to local judicial remedies and whether local courts will readily make injunctive relief available.

Franchisors should understand the practical steps to enforcement in a particular jurisdiction, not just the theory. For example, in Mexico, although arbitral awards are stated to be enforceable,¹⁵⁶ the process of executing an award can take so long that the process can be impractical. Arbitrating cross-border disputes is a common practice facilitated by the 1958 New York Convention.¹⁵⁷ However, there are some countries that have adopted requirements, whether formal or practical, that impact parties' decision on where and whether to arbitrate. As just one example, in the six Gulf Cooperation Council countries, an arbitral award is much easier to enforce if that award was rendered after a proceeding conducted within the GCC (for example, at the DIFC LCIA Arbitration Centre, under the auspices of the Dubai International Financial Centre – London Court of International Arbitration).¹⁵⁸

2. Third-Party Beneficiary issues

Although many common law jurisdictions have abolished the rule on privity¹⁵⁹ of contract, it remains the case in many jurisdictions that a person cannot enforce a contract to which it is not a party. As a result of this, a franchisor should not assume that it will have the right to bring proceedings based on a franchise agreement against its master franchisee's franchisee, and will need to consider practical workarounds, on a case by case basis.¹⁶⁰

3. Guarantees

It is often the case that although a corporate or personal guarantee may include foreign governing law or dispute forums, in practice, it becomes particularly difficult to enforce a guarantee in that case. This can be because guarantees, particularly those given by individuals, are subject to strict public policy considerations.

¹⁵⁶ Código Federal de Procedimientos Civiles [C.F.P.C.] [Federal Civil Procedure Code] *as amended*, art. 360, D.O., 24 de Febrero de 1943 (Mexico).

¹⁵⁷ Formally, the “United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards,” adopted June 10, 1958. In the U.S., the implementing statute can be found at 9 U.S.C. § 201, et seq. By the end of 2013, 149 nations had ratified the New York Convention. See New York Arbitration Convention, New York Convention Countries, <http://www.newyorkconvention.org/contracting-states> (last visited Aug. 13, 2014).

¹⁵⁸ This scope of this paper does not extend to an in-depth analysis of international arbitration. The topic has been extensively covered in other programs conducted at the ABA Forum on Franchising as well as the IBA/IFA Joint Conference on Franchising. See, e.g., Ronald K. Garner, Jr. et al., *Dispute Resolution International Style*, ABA Forum on Franchising 2012.

¹⁵⁹ Canadian provinces and most Australian States and territories still require privity of contract.

¹⁶⁰ Privity was abolished in the UK in the Contract (Third Parties) Act 1999, in New Zealand in the Contracts (Privity) Act 1982, also in the Australian jurisdictions of Western Australia in the Property Law Act 1969 (section 11 (WA)), Queensland in section 55 of the Property Law Act 1974 (Qld) and the Northern Territory in section 56 of the Law of Property Act 2000 (NT), but in no other Australian state or territory).

In Russia, as a practical matter, enforcing a guarantee written in English, governed by non-Russian law, and entered into by a Russian citizen or a Russian company is often problematic, time-consuming, and cost-ineffective. As a result of this, Russian law is the recommended choice of law if the guarantor is a Russian resident with assets located in Russia. In such a situation, the guarantee would be enforceable as both a legal and practical matter.

Under the Civil Code for the United Arab Emirates, a creditor should pursue against a guarantor within six months after a debt that has become due or possibly have the debt discharged.¹⁶¹ However, UAE courts have applied the law differently. The Abu Dhabi Supreme Court found that six month enforcement period did not apply in commercial transactions (particularly where the beneficiary is a bank or financial institutions) and instead imposed a ten year enforcement period.”¹⁶² In contrast, the Dubai Court of Cassation held that a guarantee was a civil obligation for which Article 1092 applied; meaning that the creditor had six month from the due date of payment to collect.¹⁶³

Under Chinese foreign exchange regulations, Chinese individuals cannot provide security interests (such as guarantee, mortgage, pledge, etc.) to foreign parties and Chinese companies must meet strict requirements in order to provide security to foreign parties.

Under Russian law guarantors may be banks, lenders or insurance companies. Other companies or private individuals may not provide corporate or personal guarantees.

D. Enforceability of termination rights

It is to be expected, and is commonly the case, that franchise laws include limits on when and how a franchisor can terminate a franchise agreement. In some cases, they will limit a termination right to repeated or material breaches. Others will require a minimum notice or cure period,¹⁶⁴ with limited exceptions.

In other cases, it will not be sufficient to terminate in accordance with the contract or a specific franchise law, so that a court sanction may be required. One example of this is in Mexico, where a notice of termination of the franchise agreement is not enough to have the agreement terminated.¹⁶⁵ In certain cases, a judicial declaration may be needed in order to

¹⁶¹ Article 1092 of the Civil Code (U.A.E.).

¹⁶² Mamoon Khan & Arina Gidwani, *Guarantees As Security in the UAE*, (July/August 2013), <http://www.tamimi.com/en/magazine/law-update/section-5/july-august-2/guarantees-as-security-in-the-uae.html>.

¹⁶³ *Id.*

¹⁶⁴ For example, in S. Korea, a cure period of no less than two (2) months is required and written notice at least twice stating that the franchisor will terminate the Agreement unless the breach is corrected. Fair Franchise Transactions Act, Act No. 6704 of May 13, 2002 (as amended by Law No. 8630 of Aug. 3, 2007) art. 14(1).

¹⁶⁵ See L.P.C. [Industrial Property Protection Law] art.142 bis.3, D.O., el 27 de Junio de 1991 (Mexico).

officially terminate a franchise agreement.¹⁶⁶ The notice of termination serves as evidence, but it is itself ineffective to terminate.

Ordinarily, as soon as a franchisee has been lawfully terminated (or, in the case of some countries, where it has been sanctioned by a court) the franchisor would then be free to appoint another franchisee. This is not so in Indonesia, where another step is required. Indonesia requires any disputes to be settled by the parties or a final court judgment to be obtained before the franchisor appoints a new franchisee in the same area.¹⁶⁷

Finally, franchisors should bear in mind that in jurisdictions where agreements need to be registered, the fact that the agreement has terminated may need to be notified. An example of this is Russia, which requires a termination (but not an expiration) to be registered.¹⁶⁸

E. Non-Renewal

One of the most concerning aspects of franchising regulation, both within the United States and internationally, is a trend of limiting a franchisor's rights (or providing a franchisee with additional rights) if the agreement is to expire and will not be extended or renewed. No jurisdiction mandates a renewal in all cases. In the jurisdictions outside the U.S. which deal with non-renewal, a breach by a franchisee will always enable a contract to expire without any further obligation on the franchisor, and notice and/or a waiver of any post-term non-compete will often do so.

For example, in Russia¹⁶⁹ and Lithuania¹⁷⁰ applicable laws require a franchisor to offer a new contract to an expiring franchisee on terms that are no more onerous than the original agreement, unless the franchisee was in breach – but that requirement applies only if the franchisor seeks to grant new franchises in the franchisee's territory within the three years after termination or expiration of the franchise agreement. This requirement does not prevent the franchisor from itself operating in the former franchisee's territory.

In Malaysia, a franchisee that did not breach its franchise agreement is entitled to extend its franchise term on conditions that are "similar or not less favourable" if the franchisee applies for an extension at least six months before the term expires.¹⁷¹ In addition, it is an offense to refuse to renew "without compensation" after considering the diminution of the value of the

¹⁶⁶ See L.P.C. [Industrial Property Protection Law] art.142 bis.3, D.O., el 27 de Junio de 1991 (Mexico). See <http://www.wipo.int/edocs/lexdocs/laws/es/mx/mx100es.pdf>.

¹⁶⁷ Minister of Trade Regulation No. 53/M-DAG/PER/8/2012, art. 8. This is referred to as the "clean break" requirement.

¹⁶⁸ See Russian GK arts. 1035, 1037.

¹⁶⁹ Russian GK art. 1035(2).

¹⁷⁰ L.C.C., art. 6.774 (Lith.).

¹⁷¹ Franchise Act 1998, § 34 (Malay.).

franchised business caused by the expiration, unless the franchisee has been given at least six month' notice of the non-renewal or the post-term non-compete is agreed to be waived.¹⁷²

Similarly, South Korea entitles a Franchisee to a renewal if the request is made between 90 to 180 days before the expiration of the franchise agreement, unless the franchisor has a justifiable reason (such as breach).¹⁷³ Also, a franchisee's right to request renewal of the franchise agreement may be exercised if the total period of the franchise agreement, including its initial period, does not exceed ten years. The franchise agreement is deemed to be renewed under the same terms and conditions of the original agreement if: (a) the franchisor fails to give notice of refusal on a permitted ground within 15 days from the date it receives the request of renewal; (b) between the period of 90 to 180 days prior to the expiration of the agreement the franchisor fails to provide written notice of any changes in the terms and conditions; or (c) between the period of 90 to 180 days prior to the expiration of the agreement the franchisor fails to provide written notice that it is not willing to renew the franchise agreement.¹⁷⁴ Unlike the case of other jurisdictions, in South Korea this right to renew does not arise if the total franchise term has exceeded 10 years.¹⁷⁵

Brazil does not regulate non-renewal as such, but if a franchisor elects not to renew, it could be required to compensate the franchisee if the term was insufficient in light of the investments made by the franchisee.¹⁷⁶

Under exposure draft changes to Australia's "Franchising Code", if implemented, a post-term restraint clause will have no affect after the agreement ends if the franchisee (i) was not in breach; (ii) sought to renew the franchise agreement on substantially the same terms; and (iii) was not granted a renewal or compensation for non-renewal.¹⁷⁷

In other cases, if a franchisor directly or indirectly represents to a franchisee that it will be renewed, courts may require the franchisor to do so.

V. CONCLUSION

International franchising provides a host of challenges (clearly not all covered here) throughout the lifecycle of a franchise agreement. In their native land, practitioners may experience challenges, such as pre-sale disclosure or registration issues, only to find that the

¹⁷² *Id.* § 32.

¹⁷³ Fair Franchise Transactions Act, Act No. 6704 of May 13, 2002 (*as amended by* Law No. 8630 of Aug. 3, 2007) art. 13(1) (S. Korea).

¹⁷⁴ *Id.* art. 13(4).

¹⁷⁵ *Id.* art. 13(2).

¹⁷⁶ LUIZ HENRIQUE O. DO AMARAL ET AL., INTERNATIONAL FRANCHISE SALES LAWS, BRAZIL 20 (Andrew P. Loewinger & Michael K. Lindsey eds., ABA Publishing 2011).

¹⁷⁷ Austl. Treas., 2014 Exposure Draft amendments to the Franchising Code of Conduct, <http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2014/Franchising-Code>.

same issues arise – in nuanced form – in cross border transactions because of a particular registration requirement or market study. Often, lawyers get involved in the beginning of the transaction to guide the due diligence and conduct legal review to identify the impediments to the deal. These challenges may be impediments arising from a country’s laws, political or social policies, or commercial customs – all of which may impact the local business partner or be reflected in regulatory standards such as those that would impose a set term or limit the royalty stream.

Often overlooked, however, are challenges that can be found outside the bounds of “franchise law,” as well as those that arise long after the agreement is signed and the relationship is in its operational phase. Experienced local counsel can help the parties foresee the pitfalls that may befall the operational phase of the agreement, such as where regulations impede the payment of royalty fees, limit the purchase of supplies unless from a local supplier, inhibit marketing to certain customers, or restrict working in certain areas. Of course, when the relationship lifecycle comes to an end, franchisors will also need to be aware of the time limits of guarantees, enforceability limitations of non-competes, termination provisions or requirements of renewing the franchise agreement, as well as real-world questions – such as whether injunctive relief is available as a practical matter.

Unique issues make international franchising risky and challenging. These issues challenge a practitioner’s conventional legal understanding and expand their competencies. They also force franchisors to broaden their mindset and restructure their business approach in order to excel in new regions. But for all of these issues, international franchising, with the guidance of experienced counsel in the franchisor’s home jurisdiction working in conjunction with expert local counsel, present companies with enormous opportunities that can lead to global brand recognition and increased revenue streams.

Attachment A: Threshold Due Diligence Issues

1. The Franchising Environment

- 1.1 Is franchising permitted?
- 1.2 Are there pre-conditions to advertising for franchisees, meeting with a prospect, taking a deposit, or entering into a letter of intent?
- 1.3 Is the intended structure permitted, in light of the nationality and experience of the franchisor and franchisee entity? Will local laws permit or require local equity participation? Is another structure preferable due to local laws or liabilities?
- 1.4 Are there pre-conditions to franchising (e.g. registration of trademark, registration of franchise, disclosure to potential franchisee)? When are these required? How long do they take?
- 1.5 Is there any ongoing disclosure requirement?
- 1.6 Are financial performance representations permitted? Required?
- 1.7 Could the franchise be regulated as an agency? A multi-level marketing scheme? An employment relationship? Can this be avoided?
- 1.8 Do local laws impact the term, renewal or termination of a franchise agreement? Do local laws require compensation to an expired or terminated franchisee?
- 1.9 Do execution formalities apply to the agreement?
- 1.10 What will local law require or prohibit in the franchise agreement? Will it require the local language?

2. Brand Issues

- 2.1 Can the franchisor's products be sold in the country at all? As formulated? As branded?

3. Financial Issues

- 3.1 What are the local tax consequences to the franchisor of the payments it will receive? Will these change depending on where it provides services? Where the agreement is executed?
- 3.2 Are there any barriers to (or conditions or limitations on) repatriation of funds?
- 3.3 Would local quotas, tariffs or duties apply to the importation of the franchisor's products?

4. Enforcement Issues

- 4.1 Will local courts recognize and enforce a foreign judgement or arbitral award?
- 4.2 Is injunctive relief available locally?
- 4.3 Will local foreign investment laws impact the franchisor's ability to take over a terminated franchisee's business?
- 4.4 Could local immigration laws prevent or delay the franchisor's staff from working in-country?

Penny Ward leads Baker & McKenzie's franchising practice in Australia and in the Asia Pacific region. Based in Melbourne, Penny was admitted to practice law in 1984 and has practiced franchising law for over 25 years.

Penny is a past Chair of the International Franchising Committee of the International Bar Association and has served on the Franchising Consultative Committee of Australia's franchising regulator, the Australian Competition and Consumer Commission. She acted as legal adviser to the Franchise Council of Australia Limited for many years. Penny has written and spoken widely on domestic and international franchising both in Australia and abroad, to organizations such as the Franchise Council of Australia Limited, the ABA Forum on Franchising, the International Franchise Association and the International Bar Association.

Penny has been listed as one of the most highly regarded franchising lawyers, by the International Who's Who of Franchise Lawyers.

Lee Plave is a co-founding partner of Plave Koch PLC, an entrepreneurial law firm in Reston, Virginia. He counsels franchisors and distributors, drafts and negotiates agreements for international and domestic transactions, and advises clients on all aspects of franchise and distribution law.

Lee also works with clients on how to apply technology in franchise and distribution systems, including social networking and social media issues, data, security, and e business policies, cybersquatting and domain name disputes, as well as cybersmear/complaint sites. He also represents clients before the Federal Trade Commission, where he began his career.

The International Franchise Association Educational Foundation recognized Lee as a "Certified Franchise Executive." London-based Chambers & Partners, which publishes an internationally-respected client guide, ranks Lee as one of the leading franchise lawyers in the United States. Another London-based publication, Who's Who Legal, named Lee one of the global Top 10 franchise lawyers in The International Who's Who of Franchise Lawyers.

Lee served as the Director of the International Division of the American Bar Association's Forum on Franchising from 2012-14.

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Since 2003, Chris served in several capacities with Wyndham and its predecessor, Cendant Corporation. Before moving to his current role, he was group vice president, legal, supporting antitrust, marketing, global distribution, loyalty, compliance, privacy and global development legal matters for Wyndham Worldwide' subsidiary, Wyndham Hotel Group. Prior to that, he was group vice president – international law and strategic sourcing for Wyndham Worldwide, where he was responsible for international compliance matters and international transactions, strategic sourcing transactions and various other matters, including government relations.

Before joining Wyndham, and its predecessor, Cendant Corporation, Chris was an associate with the law firm of Hogan & Hartson LLP in Washington, D.C., where he practiced franchise and antitrust law.

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