AMERICAN BAR ASSOCIATION

FORUM ON FRANCHISING

October 11-13, 1995
Orlando, Florida

AVOIDING THE LONG ARM OF THE LAW IN INTERNATIONAL FRANCHISING:

ISSUES AND APPROACHES

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AVOIDING THE LONG ARM OF THE LAW IN INTERNATIONAL FRANCHISING:

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I. INTRODUCTION

A. THE PROBLEM

In what ways might legal counsel minimize the effect of, or even avoid, laws that most typically burden international franchise arrangements? The question may at first blush appear strange: there is no specific -- or unified -- body of law regulating international franchise arrangements. But, as anyone who has been involved in international franchise arrangements can attest, there are numerous applicable laws, from several different -- and in some cases, unlikely -- sources. These include U.S. federal and state franchise disclosure laws, foreign host country laws, and international treaties. As a result, the approach of this paper is thematic, and not restricted to any single body of law.

Consider the following scenarios, which are illustrative of the types of situations that frequently arise:

- A U.S. franchisor located in California has been approached by a Taiwanese national (teaching and resident in the state of New York) who desires to purchase franchise rights in Taiwan. Taiwan has a "technology transfer law," but no franchise law. Must a disclosure document be furnished, and, if so, what type?

- A U.S. franchisor and a non-Philippine party wish to enter into a twenty-five year franchise arrangement for restaurants in the Philippines for $750,000 in initial fees, but the Philippine restrictions on foreign operation of retail establishments and in its technology transfer law prohibit the fees, the term, and the foreign party. Are there any alternatives?

As these scenarios illustrate, a host of U.S. and foreign laws typically affect and regulate the arrangement.

B. THE APPROACH

As franchising typically has arisen and grown most dramatically in the United States, most international franchising consists of U.S. franchisors expanding overseas. This paper takes the point of view of a U.S. franchisor expanding overseas. Hence, we begin our discussion of laws burdening international franchising with an analysis of U.S. franchise disclosure laws.

Nevertheless, many of the subjects covered will also apply to international franchising by non-U.S. companies.[1]

Although many laws affect international franchise arrangements, our approach is to identify and propose ways of dealing with only those types of laws that *fundamentally limit or burden* the parties' business objectives. In our experience, two types of such laws most frequently come into play.

One set of laws, namely franchise disclosure laws, may require a franchisor's compliance, even though that the law's nexus to the transaction may appear attenuated or unnecessary. This is particularly true of the franchise disclosure laws in the United States which often appear as though they *should not* apply to international transactions, but which, by their strict terms, do apply to international transactions. The applicability of U.S. franchise sales laws poses a dilemma for U.S. franchisors as to whether to comply fully (which is very burdensome) or to assume tangible legal risks. Franchise disclosure laws also now exist in Brazil, France, Mexico, and the province of Alberta. Often, the reach of these laws also appears ill-suited to international transactions.

A second set of laws would most typically require the franchisor to alter the fundamental business terms of the parties' arrangement, or the fundamental structure of the business transaction. Such restrictions typically arise from host-country laws. For example, technology transfer laws will often impose limits on the parties' business terms. Foreign exchange laws, laws restricting the franchisee's nationality, and foreign investment laws also frequently have such an effect.

It is not always possible to avoid or minimize the impact of such laws, but frequently some approach may be employed to do so. In this paper, we will first identify and briefly discuss the applicable law; then consider, where possible, its jurisdictional scope; identify any exemptions or exclusions available under such law; and, finally, identify other techniques which may be available -- *e.g.*, avoiding contacts with a specific jurisdiction; restructuring the business arrangement; entering into offshore arrangements; or recharacterizing fees or other aspects of the transaction. The specific technique to be used will depend on the law and the requirements involved.

C. TYPES OF LAWS

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[1] Such franchising might involve two additional perspectives. *First*, U.S. franchise counsel are increasingly presented with non-U.S. companies seeking to expand, through franchising, into the United States. We address this perspective briefly in Section II, below. *Second*, there remains much international franchising outside the United States -- from one non-U.S. jurisdiction to another non-U.S. jurisdiction. The discussions of non-U.S. laws will also apply to these cases.

We have organized our paper in two subject areas: U.S. and foreign franchise disclosure requirements; and other laws affecting international franchising. The discussion of U.S. franchise laws is more detailed than that of the foreign laws, largely because the authors are U.S. attorneys. In all international dealings, it is advisable to raise detailed questions with local counsel, although the U.S. attorney is likely to be the initial legal counsel and draftsperson.

1. **Franchise Disclosure Requirements**

We discuss franchise disclosure laws, first, in the United States, and, then, in other countries which have such laws. Those countries which, in addition to the United States, have national laws that specifically regulate franchise agreements are Brazil, France, Mexico. This section also includes a discussion of the disclosure requirements in the Province of Alberta, Canada, and the voluntary or self-regulatory disclosure requirements in Australia.

The discussion of foreign franchise disclosure requirements is timely, because of recent developments. On December 15, 1994, the Brazilian government enacted Law No. 8955 which requires that pre-sale disclosure be provided to prospective franchisees. In 1989 and 1991, the Loi Doubin and its "regulations", respectively, came into effect in France. In 1991 and 1994, the Industrial Property Law and the regulations, respectively, requiring pre-sale disclosure came into effect in Mexico. While an Alberta Franchise Sales Law has been in effect since 1972, Alberta passed an new Franchises Act in on May 16, 1995, which will become effective when new regulations are promulgated. In 1993, the Australian Code of Voluntary Compliance went into effect, requiring registered franchisors to provide disclosure and follow standards of conduct. As this paper goes to press, the Australian government is seriously considering making it mandatory, based upon the "Review of the Franchising Code of Practice" conducted by Robert Gardini.[2]

2. **Other Laws Affecting International Franchising**

Second, we consider other, non-franchise laws that often impose significant burdens on international franchise arrangements. The first part of this section deals with the possible extraterritorial application of the U.S. state franchise relationship laws, dealing primarily with termination and non-renewal. We next discuss the European Community's Regulation No. 4087/88 commonly known as the Block Exemption on Franchising ("EC Block Exemption"),

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[2] The voluntary code in Australia was issued with the approval of the Australian government. This paper does not deal with voluntary codes of other countries that were not issued with government approval, such as the regulations issued by the Italian Franchise Association. Bus. Franchise Guide (CCH) ¶7307. These regulations require franchisor-members to provide pre-sale disclosures to prospective franchisees. They became effective on January 1, 1995, are based on the Rules of Ethics of the European Franchise Federation ("EFF"), and are purely voluntary. Similarly, this paper does not deal with the EFF Rules of Ethics.

which regulates the substantive terms of franchise relationships within the European Community. The EC Block Exemption went into effect in February 1989.

The remainder of the paper deals with laws restricting the franchisee based on the franchisee's nationality, technology transfer laws, exchange control laws, and dealer termination laws. Laws restricting the non-national franchisee may be based either on host country law restrictions within certain industries (*e.g.*, in the restaurant business) or based on broader investment control restrictions. Such laws may restrict the ability of a non-national from doing business or investing in the host country. "Technology transfer laws" are host country laws that regulate the terms and conditions for the use of "technology" in the host country by requiring government approval for the grant of rights to use such foreign "technology" or "know how". Under such laws, governmental authorities retain the right to require changes to agreements and to disapprove certain terms in such agreements. The purpose of exchange control legislation, which exists in a number of countries, is to permit governmental authorities to regulate payments in foreign or "hard" currency outside of the country to non-nationals of such countries to avoid depletion of valuable hard currency and to minimize consumption of foreign consumer goods so as to conserve monies for domestic investment deemed necessary for economic growth.[3] Dealer termination or "agency" laws exist in a number of countries. Such laws typically have not been drafted to apply to franchise arrangements, but, given their broad wording, frequently may appear to apply to termination situations in franchise arrangements.

A wide range of laws may come into play in any given international franchise arrangement in addition to the laws described above. These may include U.S. or foreign trademark laws, antitrust laws, tax laws, import/export laws, employment laws, dispute resolution laws, and others. We do not deal with these types of laws in this paper.

II. FRANCHISE DISCLOSURE REQUIREMENTS

A. FRANCHISE DISCLOSURE REQUIREMENTS IN THE UNITED STATES

Franchise disclosure requirements in the United States are the most stringent in the world. In purely domestic transactions, franchisors face significant regulations, under both federal and state franchise disclosure laws. All franchise counsel advising U.S. franchisors on franchise offerings outside the United States have likely considered -- and been puzzled by -- the applicability of such laws to their transaction. The letter of such laws clearly appears to require compliance -- and yet the reasons for such applicability are unclear for most international transactions. We discuss, first, the applicability of the FTC Rule and, second, state franchise disclosure laws.

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[3] *See generally* Andrew P. Loewinger, *Multiple-Unit Franchise Arrangements in the Pacific Rim: Problems and Solutions*, 10 FRANCHISE L.J. 3 (1990).

The issue of the applicability of U.S. franchise disclosure requirements might also arise in the sale to a U.S. party of rights to franchise in a territory outside the United States. Foreign franchisors selling franchise rights in the U.S. presumably must comply with U.S. laws. What about a foreign franchisor who grants a master franchise agreement for all of the U.S. to a nonaffiliated U.S. company? These questions may require a close look at the relevant laws. The discussion below, however, focuses on the U.S. franchisor selling franchise rights abroad.[4]

1. **The FTC Rule**

The FTC Rule requires that pre-sale franchise disclosure be provided to a "prospective franchisee" at the earlier of the "first personal meeting" or the "time for the making of disclosures."[5]

a. Jurisdiction

An analysis of the FTC Rule must begin with the question of the jurisdictional reach of the Federal Trade Commission (the "FTC") under the Federal Trade Commission Act ("FTC Act").[6] Section 5 of the FTC Act provides that "unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are declared unlawful."[7] The FTC Act does not define what constitutes "unfair or deceptive acts or practices." The FTC was given the authority to define and prohibit certain activities that constitute such unfair and deceptive acts by promulgating trade regulation rules.[8]

Section 4 of the FTC Act defines "commerce" as follows:

> "Commerce" means commerce among the Several States or with Foreign Nations or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or

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[4] We do not address the question of what information a U.S. franchisor must furnish under the new Uniform Franchise Offering Circular Guidelines regarding its non-U.S. affiliates. Disclosure clearly appears to be required with respect to non-U.S. litigation (Item 3) and non-U.S. bankruptcy actions (Item 4). Disclosure might arguably required regarding the franchising activities by a non-U.S. franchising company (Item 1); fees payable to non-U.S. affiliates (Items 5-6); approved suppliers (Item 8); alternative channels of distribution (Item 12); trademark rights (Item 13); and outlets of the non-U.S. affiliate (Item 20).

[5] 16 C.F.R. § 436.1(a) (1994).

[6] 15 U.S.C. §§ 41-77 (1988).

[7] *Id.* § 45(a)(1).

[8] *Id.* § 57a(a)(1)(A).

> Foreign Nation, or between the District of Columbia and any State or Territory or Foreign Nation.[9]

In 1982, Congress limited the FTC's jurisdiction in certain matters related to unfair methods of competition involving commerce with foreign nations. The 1982 amendments do not apply to "unfair or deceptive acts or practices."[10] Each international franchise transaction that involves commerce between a U.S. state or territory (or the District of Columbia) with a foreign nation, or that may have an affect on interstate commerce clearly falls within the meaning of commerce as defined by the FTC Act and covered by the FTC Rule.

There are no cases in which the FTC has asserted its extraterritorial jurisdiction in an international franchise transaction. Nevertheless, the FTC has repeatedly asserted that it has such jurisdiction.[11]

The FTC's assertion of jurisdiction under the FTC Rule is in contrast to limitations on extraterritorial jurisdiction under certain similar laws -- for example, the U.S. securities laws and antitrust laws. In 1991, the Securities and Exchange Commission issued new rules clarifying the application of securities laws to foreign transactions. Under Section 5 of the Securities Act of 1933, offerors of the sale of securities are required to provide a prospectus with specified information to potential investors.[12] In 1990, the SEC clarified the extraterritorial application of the Securities Act with Regulation S, which provides that offers or sales that occur outside the United States are not subject to Section 5 of the Securities Act.[13] Regulation S establishes two exemptions for non-U.S. offers and resales, one of which applies to issuers and the other of which applies to resales. As long as the offer or sale is made in accordance with the guidelines in these exemptions, the transaction will be deemed to have taken place outside the U.S. For both issuers and resales, the offer, sale, or resale must be made in an "offshore transaction"[14] and

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[9] *Id.* § 44.

[10] *Id.* § 45(a)(3).

[11] *See, e.g.,* John M. Tifford, *The Federal Trade Commission Franchise Rule and International Franchising*, IBA/IFA ANNUAL JOINT SEMINAR ON INTERNATIONAL FRANCHISING (1987); *see generally* H. Bret Lowell, et. al., *Extra-territorial Application of US Franchise Registration and Disclosure Laws in International Franchise Transactions*, 1 J. INT'L FRANCHISING & DISTRIBUTION 8 (1993); and H. Bret Lowell & Lee J. Plave, *The Application of U.S. Franchise Laws to International Franchise Sales,* 1 GLOBAL FRANCHISING ALERT 7 (June 1994).

[12] 15 U.S.C. § 77e (1988).

[13] Offshore Offers and Sales, 17 C.F.R. 230.901-904 (1994).

[14] An offshore transaction is one in which (1) no offers are made to persons in the United (continued...)

no directed selling efforts may be made in the U.S. in connection with the offer or sale. In addition, issuers must implement a number of safeguards depending on the type of securities offered[15] to ensure that the securities offered do not flow back to the U.S.

Antitrust law also has clarification regarding foreign jurisdiction. The Sherman Act applies to "trade and commerce among the several states or with foreign nations."[16] In 1982, Congress passed the Foreign Trade Antitrust Improvements Act, which provides that the Sherman Act and key antitrust provisions of the FTC Act do not apply to "non-import" foreign trade, unless the conduct has a "direct, substantial and reasonably foreseeable effect" on U.S. commerce.[17] While Regulation S provides specific guidelines for determining which foreign transactions are exempt from extraterritorial application of U.S. securities law, the antitrust exemption for these specified, foreign activities offers only a broad standard, but few specifics. U.S. companies operating outside the U.S. must make their own evaluations as to whether their activities have the kind of "effects" on the U.S. contemplated by the Foreign Trade Antitrust Improvement Act. Yet even this broadly worded exemption provides more guidance than exists under the FTC Rule. Although a similar type of test would appear reasonable as applied to franchising, franchising law has not yet received any type of clarification on its extraterritorial application.

(...continued)
States and in which either the buyer is (or the seller reasonably believes the buyer is) offshore at the time of the origination of the buy order or (2) the sale is made in, or through, the facilities of a designated securities market. *Id.* § 230.903.

[15] The exemptions identify three categories of securities offerings: (1) securities offered in overseas directed offerings, securities of foreign issuers in which there is no substantial U.S. market interest, securities backed by the full faith and credit of a foreign government, and securities issued pursuant to certain employment benefit plans; (2) securities of U.S. reporting issuers and offerings of debt securities, asset-backed securities, and specified preferred stock of foreign issuers with a substantial U.S. market interest; and (3) all securities not contained in the other two categories. *Id.*

[16] 15 U.S.C. § 1 (1988).

[17] *Id.* § 7. The Act "makes clear that the concern of the antitrust laws is protection of American consumers and American exporters, not foreign consumers or producers." Phillip E. Areeda & Herbert Hovenkamp, ANTITRUST LAW ¶ 236a (Supp. 1994).

b. Scope of the FTC Rule

The FTC Rule applies to all "continuing commercial relationships" that are either "package and product franchises" or "business opportunity ventures."[18] Under the FTC Rule, a franchisor must furnish to a "prospective franchisee" a disclosure document describing twenty categories of information. Those failing to provide the required disclosure in a timely manner may be subject to civil actions brought by the FTC for civil penalties, injunctive relief, or consumer redress.[19]

The FTC Rule provides certain exemptions and exclusions from coverage for certain types of relationships. It provides exemptions for "fractional franchisees," "leased departments," "minimal investments," and "oral agreements."[20] The FTC Rule also provides exclusions for "employer-employee" relationships, "general business partnership" relationships, relationships created by membership in a retail owned co-operative, relationships with a testing or certification service, and single license relationships.[21] The FTC Act also permits a franchisor to petition the FTC for "discretionary exemptions," either as an individual or on behalf of a class.[22] The petitioner must show that application of the FTC Rule to the petitioner or the petitioner's class is unnecessary to prevent unfairness or deceptive practices to which the FTC Rule relates. There are no exemptions or exclusions for international transactions.

There is little evidence to suggest that the FTC Rule was designed to apply to international franchise transactions. Before the FTC Rule became effective in 1979, the FTC prepared the Statement of Basis of Purpose ("Statement"),[23] explaining its reasons for promulgating the FTC Rule. According to the Statement, after receiving numerous complaints, the FTC concluded regulation of franchising was necessary to prevent (1) the informational imbalance that exists between prospective franchise and franchisor and (2) the serious financial risk faced by prospective franchisees in entering into and operating a franchise business.[24] The FTC's concern, as expressed in the Statement, was over the impact of such unfair practices on the economy. The FTC made no reference of any kind in the Statement to franchise activities outside of the United States.

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[18] 16 C.F.R. § 436.2(a)(1)(i)-(ii).

[19] 15 U.S.C. § 45(l)-(m).

[20] *Id. §* 436.2(a)(3).

[21] *Id. §* 436.2(a)(4).

[22] *Id.* § 56a(g).

[23] Bus. Franchise Guide (CCH) ¶¶ 6,300-6,370.

[24] *Id.* at ¶ 6,314.

c. Enforcement

Since the FTC Rule became effective in 1979, the FTC has not taken any action involving the sale by a United States franchisor of franchise rights for a foreign country. Moreover, the FTC has not indicated in its enforcement policies or practices that it is seriously contemplating such action.

The FTC's decision to act generally on potential FTC Rule violations depends on a variety of factors, the most significant of which are described in its FTC Rule Enforcement Protocol.[25] The FTC Rule Enforcement Protocol provides for the administrative staff to consider the following factors in determining whether to take such action: (i) an assessment of whether the transaction is covered by the FTC Rule; (ii) an assessment of the extent of compliance with the Rule, *i.e.*, whether a disclosure document was complete and accurate, whether disclosure was furnished on a timely basis, and whether earning claims were made; (iii) an assessment of consumer injury based on such factors as the number of franchises sold in violation of the Rule; the aggregate dollar volume of revenue received by the franchisor from franchise sales in violation of the FTC Rule; the current or expected rate of franchise sales; and the amount lost by franchisees; (iv) an analysis of the remedies available, including the efficiency of injunctions, civil penalties, and consumer redress; and (v) other relevant factors, including the resources required to bring an action to an acceptable conclusion, and the likelihood of the action deterring other potential violators from failing to comply with the Rule.

In recent years, the FTC has stepped up its enforcement of FTC Rule violations by franchisors selling franchises in the United States. A brief consideration some of these actions may yield some clues as to the factors about which the FTC is most concerned in its enforcement efforts. In the last several years in recent cases, the FTC has either filed a court action or entered into consent decrees with franchisors that failed to provide a basic disclosure document[26]; failed to provide disclosure within the time required[27]; and provided illegal "earnings claim" information.[28] Domestic enforcement efforts have been principally concerned with the franchisor's failure to provide *any* disclosure document; to provide a disclosure document within the time required; and with providing improper "earnings claims".

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[25] Franchise Rule Enforcement Protocol, 16 C.F.R. § 14.17 (1994).

[26] Bus. Franchise Guide (CCH) ¶ 10,426; Bus. Franchise Guide (CCH) ¶ 10,169.

[27] Bus. Franchise Guide (CCH) ¶ 10,405; Bus. Franchise Guide (CCH) ¶ 10,244.

[28] Bus. Franchise Guide (CCH) ¶ 10,426; Bus. Franchise Guide (CCH) ¶ 10,405; Bus. Franchise Guide (CCH) ¶ 10,397; and Bus. Franchise Guide (CCH) ¶ 10,218.

No private right of action exists under the FTC Rule.[29] Nevertheless, there remains the possibility that an aggrieved franchisee may successfully "bootstrap" its claims for violations of the FTC Rule under various state "little FTC Acts." For example, in *Morgan v. Airbrooke*,[30] a company, found to be a franchisor that had fraudulently sold a franchise, was found to have engaged in a *per se* violation of the New Jersey Consumer Fraud Act due to its FTC Rule violations. It should be noted, however, that both the wording and judicial interpretation of state "little FTC Acts" may not furnish the franchisee with sufficient standing to commence an action.

d. Practical Approaches

Full compliance with the disclosure requirements of the FTC Rule presents a dilemma for franchisors seeking to comply fully with the law and yet timely consummate an international transaction. Both the FTC Rule and the Uniform Franchise Offering Circular Guidelines ("UFOC Guidelines") require that many Items in a franchisor's offering circular reflect the terms of the relevant agreements. For nearly all international transactions, a franchisor will make numerous changes to its domestic, U.S. agreements for use in the international marketplace. Such changes may be based either on a franchisor's standard form of international agreements (if used) or changes to its domestic agreements on a case-by-case basis. In either case, such changes may include those necessary, for example, (i) to structure the transaction to permit sub-franchising or to provide for other multiple-unit development; (ii) to internationalize the transaction -- for example, to provide for currency conversion, arbitration provisions for dispute resolution, and to take into account local country law; and (iii) to provide for various "negotiated changes" by the foreign party.

We outline below possible approaches a franchisor may take under the FTC Rule. The approach each company adopts will likely depend upon its consideration of a variety of "risk factors". Risk of action from the FTC is likely to be high if certain factors are present. Such factors would likely include fraud or other "unfair or deceptive acts or practices"; the failure to provide any disclosure; injury to U.S. individuals or other U.S. parties, or some other U.S. nexus; flagrant use of earnings projections; the presence of an unsophisticated franchisee, not represented by counsel; and the lack of any other available remedies. Finally, as no private right of action exists under the FTC Rule, the risk of any direct action by a franchisee based on a FTC Rule is likely to be limited to actions brought under state "little FTC Acts."

(1) Avoid Jurisdiction

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[29] *See* Wright-Moore, Corp. v. Ricoh Corp., Bus. Franchise Guide (CCH) ¶ 10,111 (7th Cir. 1992); Layton v. AAMCO Transmissions, Inc., Bus. Franchise Guide (CCH) ¶ 9,471 (D. Md. 1989).

[30] Bus. Franchise Guide (CCH) ¶ 18,560. *But see* First Mutual, Inc. v. Rive Gauche Approval Distribution, Ltd., Bus. Franchise Guide (CCH) ¶ 9,736, (D. Mass. 1990) (holding dealer contractually waived its rights under the state "little FTC Act").

One possible approach would be for a U.S. franchisor to sell foreign franchise rights through a foreign affiliate that is not subject to U.S. jurisdiction. Such an approach would require that the foreign affiliate have no contact with the United States that would otherwise subject it to the FTC's jurisdiction. If the affiliate is established for the purpose of avoiding the FTC Rule, there may be a risk that the FTC might view the transaction as an unlawful scheme to evade the law. This might be the case, for example, if the U.S. franchisor owns the foreign trademarks and requires its offshore affiliate to pay royalties based on the affiliate's franchising activities. A safer approach might be to assign the foreign trademarks to an offshore affiliate, so that no royalties will be paid to the U.S. company. In this scenario, the U.S. company, which might own the shares of the offshore affiliate, would benefit by the growth in value of the offshore affiliate, and the U.S. company might receive dividends in its capacity as a shareholder.

In any event, given the breadth of the definition of "commerce" under the FTC Rule, it may prove difficult in practical terms for a foreign affiliate to avoid any contact related to the transaction with its affiliated U.S. franchisor.

(2) Seek Exemption

As the FTC did not contemplate international transactions when providing for exemptions or exclusions under the FTC Rule, there is no enumerated exemption or exclusion for overseas transactions. A United States franchisor could apply to the FTC for a discretionary exemption pursuant to the FTC Act,[31] but this is also unlikely to be practical because discretionary exemptions are time-consuming, and the likelihood of FTC action may appear to be so low that it would not warrant the burden of obtaining a discretionary exemption for international transactions. Moreover, since it is likely that the FTC might not give the desired response, it is not desirable to seek a discretionary exemption unless the franchisor runs a serious risk of otherwise violating the FTC Rule.

(3) Restructure the Transaction

Restructuring a transaction often is a viable approach in avoiding the applicability of host country laws. Under the FTC Rule, it is difficult for a franchisor to readily avoid the three definitional elements of a "franchise" under the FTC Rule, because nearly all such transactions contain the requisite "fee," "trademark," and "significant control or assistance" elements.

If the franchisor is willing to make fundamental structural changes for the purpose of entering a particular country, there are several "radical" approaches a franchisor might take. For one, a franchisor might expressly prohibit the distributor's use of the supplier's trademark. Clearly, this is an extreme step to take, and it will not work for most franchisors. Another extreme approach would be for the franchisor to refrain from exercising significant control and from giving significant assistance. This is easier in an international context than in a purely U.S.

[31] 15 U.S.C. § 56a(g).

arrangement, but the lack of control or assistance may also damage the goodwill of the franchisor. Another "radical" approach to avoid the FTC Rule would be to establish a foreign affiliate and open only company-owned stores.

A more realistic approach might be to refrain from charging any fees, at least until after the franchisee has been in business for at least six months. This simple change in the arrangement will exclude the application of the FTC Rule. It does not matter how high the fees or royalties are after the first six months. Payments for the sale of goods at a bona fide wholesale price for reasonable amounts of merchandise to be used for resale will not constitute franchise fees under the FTC Rule.

Another possible way of avoiding the FTC Rule is for the U.S. franchisor to approach foreign dealers with established businesses, or a foreign company that has its own franchise or company-owned system in place and propose that such company adopt your product as an authorized addition to its franchise or distribution program. This can provide instant expansion at a low cost, and might qualify as a "fractional franchise" under the FTC Rule. The exemption for "fractional franchises" is available only if the franchisee or any of its directors or executive officers has had more than two years of prior management experience in the business represented by the franchise, and the parties anticipate at the time of entering into the agreement that sales under the agreement will represent no more than 20% of the dollar volume of the franchisee's projected gross sales within the reasonably foreseeable future.

(4) Provide U.S. Offering Circular

"Substantial compliance" with the requirements of the FTC Rule is one practical approach used by many U.S. franchisors. Under such an approach, the franchisor would "substantially comply" with the requirements of the FTC Rule by providing one of several documents to the prospective franchisee. Such a document could include: (i) the franchisor's standard U.S. disclosure document; (ii) the franchisor's standard U.S. disclosure document in conjunction with a supplemental document for use in connection with the subject transaction; or (iii) an international offering circular.

Use of a domestic offering circular only is likely to be the riskiest of these three approaches, but it is most appealing for reasons of convenience. Preparation of a supplemental document may also be used, but this is likely to prove burdensome (particularly if it is fully responsive to all Items), especially in light of the fact that most international transactions are negotiated.

Finally, the United States franchisor may prepare an "international franchise offering circular" for use in international transactions. This approach makes sense if the United States franchisor will be offering a "standard" arrangement in all countries. However, although a standardized approach to international transactions may be desirable, it is rarely possible. An "international offering circular" would not account for regional variations and negotiated changes.

(5) Contractual Acknowledgements

To fill in "the gap" between the international agreement and a United States franchisor's U.S. offering circular, a franchisor may, with a relatively modest burden, obtain the franchisee's explicit acknowledgement of the differences. This may be done in one of two ways. First, the U.S. franchisor may obtain the franchisee's contractual acknowledgement of the various "material" terms of the parties' contractual arrangements which are at variance with those described in the offering circular. Terms typically varied in international arrangements might include site selection assistance; terms relating to the manual; trademarks; and product distribution and supply arrangements. As a practical matter, such terms are likely to be included in the parties' agreement in any event.

An alternative approach might be for the franchisor and franchisee to recite such material variations in a supplemental acknowledgement that certain aspects of the franchisor's U.S. offering circular do not fully address the arrangements under the parties' contract. By using either approach, explicit acknowledgement of the obligations (and limitations on the obligations) that the franchisor is to provide to the franchisee will likely prove useful in the event that the failure to provide disclosure is ever challenged, or in the event that any issues later arise under the offering circular as to pre-contractual representations made to the Franchisee.

When in doubt, it is always advisable explicitly to exclude by contract the application of the FTC Rule. It is doubtful, however, that this contractual exclusion will be effective, by itself, to bring the transaction outside of the reach of the FTC Rule.[32]

(6) Full Compliance

Full compliance with the disclosure requirements of the FTC Rule is an unrealistic option in nearly all situations, but remains nonetheless available. Full compliance would require full disclosure in the offering circular of all relevant terms under the UFOC Guidelines for a particular transaction. As numerous terms in most international transactions tend to be different from those in a franchisor's domestic offering circular, this approach would be highly burdensome on a case by case basis.

2. U.S. State Franchise Disclosure Laws

Fifteen states have franchise sales laws that, like the FTC Rule, require franchisors to make extensive disclosure at the time a franchise is offered or sold. Fourteen of these states also

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[32] *But see* First Mutual, Inc. v. Rive Gauche Approval Distribution, Ltd., note 29 *supra*. We have assumed in the discussions of U.S. laws in this paper that the court or tribunal would be located in the United States and would apply relevant U.S. laws and rules of construction. This may not always be the case in international transactions.

require registration of the franchise offering.[33] Failure to comply with the state franchise disclosure laws can result in fines or penalties, criminal penalties, and administrative proceedings commenced by state franchise authorities, and private actions commenced by franchisees.

a. Jurisdiction

Most of the state franchise disclosure laws apply in the event of an "offer" or "sale" of a franchise in the state.[34] Under the laws of a number of these states, an offer or sale is made in the state when an offer to sell is made in the state or an offer to buy is accepted in the state, or, if the franchisee is domiciled in the state, the franchised business is or will be operated in the state, or a variation of these concepts.[35] Such franchise laws typically define when an "offer to sell" is made in the state as when the offer (i) either originates from the state or is directed by the offeror to the state and received at the place to which it is directed and (ii) is accepted in the state when acceptance is communicated to the offeror in the state. Acceptance is communicated to the offeror in the state when the offeree directs it to the offeror in the state reasonably believing the offeror to be in the state and it is received at the place to which it is directed.[36] In short, given the broad sweep of the franchise sales laws, such laws are likely to apply to the offer of international franchise rights, if (i) the offer originates from the state, (ii) is accepted in the state, or (iii) is made to a domiciliary of the state.

There are no cases in which a state franchise sales law has been applied to an international franchise transaction. The New York franchise authorities have openly and clearly taken the position that the New York franchise sales law applies extraterritorially. There is authority for this position in the case of *Mon-Shore Management v. Family Media*, 584 F. Supp.

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[33] Because more than just disclosure is required, these laws are sometimes referred to as franchise "sales" laws. We refer to them as franchise "disclosure" laws for the sake of consistency.

[34] CAL. CORP. CODE § 31110; HAWAII REV. STAT. § 482E-3(A); 1987 ILL. LAWS § 85-551-6; MD. CODE ANN. § 14-214(A); MICH. COMP. LAWS ANN. § 445.1508(1); MINN. STAT. ANN. § 80C.02; N.Y. GEN. BUS. LAW § 683.1; N.D. CENT. CODE § 51-19-03; OR. REV. STAT. § 650.010; R.I. GEN. LAWS § 19-28.1-4(A); S.D. CODIFIED LAWS ANN. § 37-5A-6; VA. CODE § 13.1-560; WASH. REV. CODE ANN. § 19.100.020(1); WIS. STAT. ANN. § 553.21.(1).

[35] CAL. CORP. CODE § 31013(A); 1987 ILL. LAWS § 85-551-6; MD. CODE ANN. § 14-203; MICH. COMP. LAWS ANN. § 445.1504(2); MINN. STAT. ANN. § 80C.19(1); N.Y. GEN. BUS. LAW § 681.12(A); N.D. CENT. CODE § 51-19-02(14)(B)(1); OR. REV. STAT. § 650.015(1); R.I. GEN. LAWS § 19-28.1-4; S.D. CODIFIED LAWS ANN. § 37-5A-7.1; WIS. STAT. ANN. § 553.59.(1).

[36] *See, e.g.*, CAL. CORP. CODE § 31013(b).

186 (S.D.N.Y. 1984).[37] In that case, the court applied the New York Franchise Sales Act when the offer merely originated in New York, even though the offerees and the franchised businesses were outside the state. This holding was based, in part, on the broad territorial scope of the New York franchise law.

b. Summary of State Franchise Disclosure Laws

As in the FTC Rule, the definition of a "franchise" under most state franchise laws has three elements. The trademark and fee elements of the state laws are parallel to the FTC Rule; but instead of control or assistance, the state laws refer either to the sale of goods or services under "marketing plan or system prescribed in substantial part by a franchisor"[38] or a "community of interest" between the franchisor and franchisee.[39]

Nearly all state franchise sales laws require the amendment of the franchisor's offering circular in the event of any "material change."[40] The material change may or may not be defined under state franchise sales law, depending on the state. Most changes in international agreements would likely constitute material changes under state franchise sales laws.

Many state franchise sales laws have anti-fraud provisions which provide that it is unlawful for a person, in connection with the offer or sale of a franchise, (i) to employ any device, scheme or artifice to defraud; (ii) to make any untrue statements of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading; or (iii) to engage in any act which operates or would operate as a fraud or deceit on a person.[41]

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[37] *Compare Re Montgomery Ward Catalog Sales*, 680 F. Supp. 182 (E.D. Pa. 1987) (decided under prior Illinois law). *See also* Highway Equipment Co. v. Caterpillar, Inc., Bus. Franchise Guide (CCH) ¶ 9,644 (6th Cir. 1990) (holding that the Illinois Franchise Disclosure Act did not cover an Ohio franchise expressly governed by Illinois law because the Act had no extraterritorial application without express legislative intent to do so).

[38] *See e.g.,* CAL. CORP CODE § 31005 (a).

[39] *See, e.g.,* S.D. CODIFIED LAWS ANN., ch. 37-5A-1.(1).

[40] *See, e.g.,* IND. CODE ANN. § 20-2.5-20(a).

[41] *See e.g.,* IND. CODE ANN. § 23-2.5-27.

c. Exclusions and Exemptions

For U.S. franchisors venturing abroad, the laws of some of these states will not pose an obstacle, even if the prospective franchisee negotiates and signs the agreement in the state, due to certain exemption and exclusions. The Virginia franchise sales law clearly does not apply where the franchise business is not to be located in the state.[42] The Indiana franchise sales law does not apply where the franchise business is not to be operated in the state, and the offeree or franchisee is not an Indiana resident.[43] In Hawaii and Michigan, there is an exemption from both registration and the detailed disclosure requirements, but not from the antifraud provisions, where the offeree is a nondomiciliary and the franchise business will not be operated in the state.[44] In Illinois, a franchisor that is not registered in the state may not sell or offer to sell a franchise if: (i) the franchisee is domiciled in Illinois, or (ii) the offer of the franchise is made or accepted in Illinois and the franchised business is or will be located in Illinois.[45]

An offer or sale is exempt from registration in California, Maryland, Minnesota, Rhode Island and Wisconsin if the offeree is non-resident, non-domiciliary and not present in the state, the franchise business is not to be located in the state, and there is no violation of the law of any foreign state, territory, or country, or, in the case of California, Rhode Island and Wisconsin, of the United States.[46]

Although "out-of-state" sales exemptions would appear to be ideally suited to international franchise transactions, they in fact may provide limited relief to franchisors. In the case of the exemption in California, Maryland, and Minnesota, although the franchisee may not be a resident or domiciliary of the state; a prospective franchisee will often be "present" in the state at some point during the negotiations or prior to the sale. What constitutes "presence" and the requirement for timing of such presence are both unclear. In addition, all of the exemptions require compliance with the laws of foreign jurisdictions, including the laws of another state, and several of the exemptions require compliance with U.S. law. In these states, the franchisor must comply with the FTC Rule, whether through disclosure, exemption or otherwise, in order to qualify for the state exemption.

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[42] The Virginia franchise sales law applies only to a franchise the performance of which contemplates or requires the franchisee to establish or maintain a place of business within the Commonwealth of Virginia. VA. CODE ANN. § 13.1-559B.

[43] IND. CODE ANN. § 23- 2.5-2.

[44] HAW. REV. STAT. § 482E-4(a)(4); MICH. COMP. LAWS ANN. § 445.1506(1)(d).

[45] 1987 ILL. LAWS, Ch. 85-551, § 10.

[46] CAL. CORP. CODE § 310.100.1; MD. CODE ANN. BUS. REG. § 02.02.10.04A; MINN. STAT. ANN. § 80C.03(H); R.I. GEN. LAWS § 19-28.1-7; WIS. ADMIN. CODE § 32.05(1)(E).

The states of New York, North Dakota, Oregon and South Dakota have no exemptions or exclusions from the applicability of their franchise sales laws such as those described above.

Certain states also provide exemption from the registration or disclosure requirements in the case of a "negotiated change". The California franchise sales law exempts from the law's registration provisions the offer or sale of a franchise on terms different from the terms of a registered offer.[47] In the Illinois franchise sales law, an amendment is not required to a registered offering if the terms of the franchise agreement merely reflect changes from the franchisor's registered franchise made pursuant to negotiations between the franchisee and franchisor.[48] In the Washington franchise sales law, a franchisor does not need to provide an amended offering circular to a prospective franchisee due to a change in the terms and conditions resulting from changes negotiated at the initiative of the franchisee.[49] In Virginia, a franchisee may declare a franchise void if he was not afforded the opportunity to negotiate with the franchisor on all provisions.[50]

A variety of additional exemptions are also available. Two types of such exemptions may be useful to franchisors in international transactions. One such type of exemption is the so-called "large franchisor" exemption. For example, the California franchise sales law exempts offers by a franchisor with a net worth of at least $5,000,000 which either has had twenty-five franchisees conducting business during the last five years or has conducted the business which is the subject of the franchise for at least five years. In New York, such a large franchisor may apply for an exemption; but the exemption is automatic only if the franchisor has a net worth of at least $15,000,000. Other states with large franchisor exemptions include Indiana, North Dakota, Rhode Island, South Dakota, Washington and Wisconsin.[51] These exemptions generally apply to the registration requirements, not the disclosure requirements. A state may also require a notice filing even if the exemption applies.

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[47] The following conditions must be satisfied: (i) the original offer must be registered; (ii) the prospective franchisee must receive a Notice of Negotiated Sale of Franchise filed with the Department of Corporations within the preceding 12 months; (iii) the franchisor must amend its registered offer to disclose negotiated changes; (iv) a Notice of Negotiated Change for the subject transaction must be filed within 15 business days after the transaction; and (v) the franchisor must declare in any renewal application that it has filed all such Notices. CAL. CORP. CODE § 310.100.2(a)

[48] 1987 ILL. LAWS, ch. 85-551, § 11.

[49] WASH. REV. CODE ANN. § 19.100.184

[50] VA. CODE ANN., § 13.1-565(b).

[51] *See, e.g.,* CAL. CORP. CODE §31101(a); IND. CODE ANN. § 23-2-2.5-3; N.Y. GEN. BUS. LAW § 684; N.D. CENT. CODE § 51-19-04(1); R.I. GEN. LAWS § 19-28.1-6; S.D. CODIFIED LAWS ANN. § 37-5A-12; WASH. REV. CODE ANN. § 19.100.030(4); WIS. STAT. ANN. § 553.22.

A second type of exemption is a discretionary exemption available under a number of state franchise sales laws.[52] Under a discretionary exemption, a franchisor may obtain exemption by order from the registration requirements of a state franchise sales law on application to the state franchise authorities.

Finally, it is possible in a number of states to obtain an interpretive opinion from the franchise authorities that the state's franchise sales law does not apply to a particular transaction.[53] Typically interpretive opinions are not considered binding authority.

d. Practical Approaches

The approach each franchisor chooses is likely to depend upon a variety of "risk factors". Under state registration and disclosure laws, there is a risk of a private right of action by the franchisee as well as action by state franchise authorities. In the absence of fraud, state franchise authorities are unlikely to be concerned about registration of either a supplemental offering circular or an international offering circular, given the relative sophistication of the parties. There do exist, however, greater risks of legal action from a disgruntled franchisee. The risks are likely to be greatest with the presence of the following factors: fraud or other deceptive act or practice; the failure to provide *any* disclosure; injury to U.S. individuals or other parties; flagrant misuse of earnings projections; the presence of an unsophisticated franchisee, not represented by counsel; and the lack of any other available remedies. It may be necessary for a disgruntled franchisee to prove some causal connection between (i) the failure to register, or amend registration, and disclose the terms of a specific transaction and (ii) any injury alleged. In addition, the anti-fraud provisions of state franchise sales laws or "little FTC Acts" may also provide the basis for a claim by a disgruntled franchisee.

(1) Avoid Jurisdiction

Several possible approaches exist to avoid the jurisdiction of state franchise sales law. *First*, in certain of the registration states (*e.g.*, Virginia) the jurisdiction of the franchise sales law may not reach transactions where the franchise business is to be located outside the state. In Hawaii, Indiana, Illinois and Michigan, however, if the franchisee is domiciled or resident in the state, then the transaction would be within the state franchise sales law's jurisdictional reach.

A *second* approach would be to sell franchise rights through a foreign affiliate not subject to the jurisdiction of a state franchise sales law -- *e.g.*, by establishing an affiliate for international sales in a non-registration state or outside of the United States. Such an approach might be difficult for the reasons discussed in Section II.A.1.d (1), above, with respect to the FTC Rule. Moreover, given the "hair-trigger" definitions for "offer" and "sale" used in many

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[52] *See, e.g.,* WISC. STAT. ANN. § 553.25.

[53] *See e.g.,* CAL. CORP. CODE § 31510.

state franchise sales laws, it would be more difficult for a franchisor in a registration state to avoid contacts in an international transaction than under the FTC Rule.

An approach to avoid the jurisdiction of the state franchise disclosure laws does not have to be as elaborate as setting up an off-shore affiliate. It may be sufficient simply to sell the franchises from a state that does not have such laws.

(2) Utilize Exemption

To avoid applicability of a state franchise disclosure law, a U.S. franchisor could seek to utilize an available exemption or to restructure the transaction. None of the state franchise sales laws appear to have specifically contemplated international transactions when providing for exemptions or exclusions. The "out-of-state" sales exemptions, which exist in only a few state franchise sales laws, appear most appropriate to international transactions, but there frequently exist problems with utilizing such exemptions, for the reasons given in Section II.A.1.d (2), above, with respect to the FTC Rule. A U.S. franchisor could also seek to utilize other exemptions -- *e.g.*, large franchisor exemption, a discretionary exemption, or an interpretive opinion. Many franchisors will not satisfy the conditions for a "large franchisor" exemption. Moreover, even for those franchisors that do, such exemptions may only exempt a franchisor from the registration, but not disclosure, requirements under state franchise sales laws. In such case a franchisor would face the issues relating to conforming the disclosure document to the specific transaction as described in Section II, above.

In theory, a franchisor could also seek to obtain an interpretive opinion from a state franchise authority that an international transaction is not intended to be covered. This approach may be viable in some circumstances -- *e.g.*, if a prompt opinion can be obtained or for a franchisor located in a registration state that anticipates engaging in multiple international franchise transactions. Such an approach has several deficiencies, however. For example, an undesired or inconclusive opinion may result. The transaction may be delayed. Finally, such interpretive opinions are typically not binding on either the state authorities or on a private party.

Franchisors could also seek to rely on the "negotiated change" provisions of various state franchise sales laws to avoid the registration requirements and to avoid amending their disclosure documents for specific international transactions. The negotiated change provisions are unlikely to provide a safe harbor generally for several reasons. *First*, only a few state franchise sales laws have provisions relating to negotiated changes. Although the franchise administrators in many of the other registration states take the position that amendment of a registered offer is not required in the case of a "negotiated change", there is no binding authority in such states on which a franchisor can rely in the event of a private party dispute. *Second*, even in the state franchise sales laws providing for "negotiated changes", such provisions seem ill-suited to international transactions. "Negotiated changes" are typically defined as changes initiated by the franchisee. Many provisions in international agreements, by contrast, are included by the franchisor (*e.g.*, for international transactions generally or for a specific transaction) and are not, in fact, negotiated changes.

(3) Restructure the Transaction

A franchisor might also seek to "restructure" the transaction, but this is unlikely to be workable for most U.S. franchisors that have established franchise systems in the United States being licensed for use in a foreign country. As discussed in Section II.A.1.d (3), above, with respect to the FTC Rule, this approach is unlikely to work unless the franchisor is willing to make basic or radical changes in the structure of the franchise.

For example, a franchisor might refrain from charging any fees or royalties whatsoever to the foreign franchisee, except for the sale of goods at a bona fide wholesale price for reasonable amounts of merchandise to be used for resale. Another radical change would be for the franchisor to open only company-owned stores abroad. Also, the franchisor can approach a foreign company that has its own franchise or company-owned system in place and propose that such company adopt the U.S. franchisor's product or service as an authorized addition to its franchise or distribution program.

In "marketing plan" states, a franchisor might avoid the application of the state franchise law by not prescribing a marketing plan. In states that define a franchise as including a marketing plan, a franchisor might make the marketing plan entirely optional, leaving purchasers free to run their businesses as they like. The marketing plan must generally be "prescribed" in substantial part by the franchisor. This may be easier in an international transaction than in a U.S. transaction, because a U.S. franchisor will rely more on a foreign franchisee to determine the marketing approach to the foreign market. Elimination of the marketing plan element will not work to avoid the New York law. As long as a franchise fee is required, the New York franchise law covers arrangements that include either a prescribed marketing plan *or* the use of the franchisor's trademark.

(4) Provide U.S. Offering Circular

A United States franchisor may seek to "substantially comply" with the applicable state registration and disclosure laws by providing one of several documents to the prospective franchisee. As noted in Section II, above, such a document could include: (i) the franchisor's standard U.S. disclosure document; (ii) a standard international offering circular; or (iii) the franchisor's standard U.S. disclosure document in conjunction with a supplemental offering circular for use in connection with the subject transaction.

As a practical matter, a franchisor would register its domestic offering circular or a standard international offering circular, if used, but would not likely register a supplemental offering circular used for an individual transaction. Use of a domestic offering circular only is likely to be the riskiest of the three approaches available, as it would (i) not comply with the requirement to amend the offering circular in the event of a material change and (ii) would arguably violate the anti-fraud provisions of a state's franchise sales law. It is, however, the least burdensome of the three approaches. The use and registration of a standard "international franchise offering circular" assumes that the United States franchisor will be offering a

"standard" arrangement in all countries. Moreover, it fails to address the need to amend the offering circular when the standard arrangement is changed by the franchisor for an individual transaction or negotiated by the franchisee. Finally, preparation and registration of a supplemental offering circular would likely prove the most burdensome of these three approaches, as most international transactions are negotiated, and amendment will prove time-consuming and may interfere with the subject transaction.

(5) Contractual Acknowledgements

To fill in "the gap" between the international agreement and a United States franchisor's U.S. offering circular, a franchisor may, with a relatively modest burden, utilize the contractual acknowledgements described in Section II, above. The use of such acknowledgements could prove very useful to a franchisor as a defense to a claim that the franchisor's failure to register an offering circular and to disclose the terms of a specific transaction caused injury.

(6) Full Compliance

Full compliance with both the registration and disclosure requirements of an applicable state franchise sales law is an unrealistic option in nearly all situations, but nonetheless remains available. Full compliance would require registration or amendment of registration of all the terms of international transaction under the UFOC Guidelines. As numerous terms in most international transactions tend to be different from those in a franchisor's domestic offering circular, this approach would be very time-consuming and burdensome on a case-by-case basis.

B. FOREIGN FRANCHISE DISCLOSURE REQUIREMENTS

In addition to the franchise disclosure requirements of the FTC and a number of U.S. states, franchisors venturing abroad must bear in mind the franchise disclosure laws in Brazil, France and Mexico, and in the Province of Alberta, Canada, as well as the Australian voluntary disclosure "requirements". The following discussion of these foreign disclosure requirements deals only with their scope and application. It does not include sections dealing with practical approaches, because these laws tend to be so all-inclusive that they will apply to almost any franchisor entering the country.

1. **Brazil**

Until recently, Brazil's legal system made it almost impossible for entry by foreign franchisors. The authorities would require low royalty rates and short terms in franchise agreements, and conversion of payments into U.S. dollars was extremely difficult. Franchise agreements, like other agreements requiring foreign exchange payments, were required to be registered with the National Institute of Industrial Property ("INPI"), the Brazilian equivalent of the U.S. Patent and Trademark Office. In recent years, Brazil has lifted the low ceilings on royalties and making it easier to transmit royalties to a foreign franchisor.[54]

Brazil has now enacted a franchise disclosure law, which became effective on February 14, 1995 ("Law").[55] The Law requires only disclosure -- it does not contemplate registration. In fact, the Law specifically states that the validity of the franchise contract is not dependent on it being registered with a registry office or public office.[56]

a. Jurisdiction

The Law includes two statements of jurisdiction. Article 1 provides that the Law applies to commercial franchising agreements. Article 8 provides that the Law applies to the franchising systems established and operated in Brazil. Clearly, this means that any offer or sale of a franchise that will have sales locations in Brazil will be within the jurisdiction of the Law. It is not clear whether the Law would apply to a Brazilian franchisor granting franchise rights to a foreign party to establish franchises outside of Brazil.

b. Scope of the Law

The definition of a franchise under the Law is broad and encompasses many types of commercial relationships. The Law defines a franchise as:

> a system whereby a franchisor licenses to the franchisee the right to use a trademark or patent, along with the right to distribute products or services on an exclusive or semi-exclusive basis and, possibly, also the right to use technology related to the establishment and management of a business or operating system developed or used by the franchisor, in exchange for direct or indirect

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[54] INPI Resolution 35/92. *See also* Stephanie K. Wade and Andrew P. Loewinger, *Window of Opportunity: New Brazilian Regulations will Facilitate Franchising,* 2 FRAN. LEGAL DIG. 18 (1992).

[55] Law No. 8955 of December 15, 1994, Bus. Franchise Guide (CCH) ¶7302.

[56] *Id.* at art. 6.

> compensation, without, however, being characterized as an employment relationship.[57]

The definition is similar to the one used by other countries, albeit more expansive. The Law requires that the business relationship involve three elements before it is deemed a franchise. The first required element under the Law is a license of the right to use a trademark or patent. This is a very broad requirement. There is no qualification on the nature of the license provided. Presumably, a contract granting even minimal rights to use a trademark or patent will satisfy this requirement.

The second required element is a right to distribute products or services on an exclusive or semi-exclusive basis. Again, the Law contains no explanation of this condition. What is a "semi-exclusive" basis?

The third required element is that rights are given in exchange for compensation, but not pursuant to an employment relationship. There must be some form of payment for the trademark or patent license and distribution rights. Even a small fee for services related to the franchise could satisfy this element of the definition.

The Law also includes reference to an optional fourth element -- the right to use related technology developed or used by the franchisor. Since this element is optional, it is not properly speaking an "element" at all, and its inclusion appears to be superfluous.

Franchisors whose business relationships are within the jurisdiction of the Law and within the definition of a franchise must determine who must provide and who must receive disclosure under the Law.

Exactly who must provide disclosure is unclear. The Law states that a franchisor must provide a disclosure document "whenever the franchisor has an interest in the implementation of a franchise system." There is no explanation of the term "interest." The Law provides some clarification in Article 9, which states as follows:

> For purposes of this law, the term "franchisor" whenever used in any of its provisions, shall also refer to the subfranchisor and, likewise, the provisions which refer to the "franchisee" also apply to the subfranchisee.[58]

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[57] *Id.* at art. 2.

[58] *Id.* at art. 9.

This article appears to mean that a U.S. franchisor appointing a master franchisee for a country must comply with the Law in the offer of the master franchise agreement, and that the master franchisee will then be required to comply with the Law in its sale of franchises.

c. Disclosure Requirements

The Law requires that the disclosure document be sent to prospective franchisees at least ten days before signing of the franchise agreement or preliminary franchise agreement, or before any payment of any fee by the franchisee to the franchisor, or related company or individual.[59] Thus, prospective franchisees merely discussing the purchase of franchise rights need not be furnished disclosure.

The Law also sets other standards for franchising relationships and disclosure. First, all franchise contracts must be in writing and signed in the presence of two witnesses.[60] Second, the disclosure document must "be written in clear, accessible language," a requirement that appears to be much like the "plain English" requirement under the UFOC Guidelines.[61]

The Law sets forth fifteen categories of information that franchisors must include in the disclosure document.[62] The categories are broad and contain little guidance on the type of

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[59] *Id.* at art. 4.

[60] *Id.* at art. 6.

[61] *Id.* at art. 3.

[62] *Id.* at art. 3. The Law requires pre-sale disclosure of the following information:

I. Summarized background, business form and complete name or commercial name of the franchisor and of all companies related thereto, as well as their respective trade names and addresses;

II. Balance sheets and financial statements of the franchisor company for the two preceding years;

III. Clear description of all the pending lawsuits involving the franchisor, its controlling companies and owners of trademarks, patents and copyrights related to the operation, and their sub-franchisors, specifically questioning the franchising system or that might directly result in the inability to operate the franchise;

IV. Detailed description of the franchise, general description of the business and of the activities which will be performed by the franchisee;

V. Characteristics of the "ideal franchisee" regarding previous experience, educational background and other characteristics which he/she must necessarily or preferably have;

(continued...)

[62](...continued)

VI. Requirements regarding the direct involvement of the franchisee with the operation and management of the business;

VII. Specifications regarding:

(a) estimated initial investment necessary for the acquisition, establishment and startup of the operations of the franchise;

(b) value of the initial affiliation fee or franchise fee and of the guarantee; and

(c) estimated cost of the facilities, equipment and initial inventory and respective payment conditions:

VIII. Clear information regarding periodic fees and other amounts to be paid by the franchisee to the franchisor or to third parties appointed thereby, detailing the respective calculation base and what is being compensated thereby or the purpose thereof specifically indicating the following:

(a) periodic compensation for the use of the system, of the trademark or for the service effectively performed by the franchisor to the franchisee ("royalties");

(b) lease of the equipment or premises;

(c) advertising fee or similar;

(d) minimum insurance; and

(e) other amounts due to the franchisor or third parties related thereto;

IX. Complete listing of all the franchisees, sub-franchisees and sub-franchisors of the chain, as well as of all those who have disassociated themselves with it within the last twelve months, with name, addresses and telephone numbers;

X. The following shall be defined regarding territory:

(a) if the franchisee is guaranteed exclusivity or right of first refusal in any particular territory or activity and, if so, under what conditions; and

(b) possibility of the franchisee selling or rendering services outside its territory or effecting exports;

XI. Clear and detailing information regarding the obligation of the franchisee of acquiring any goods, services or materials necessary for the establishment, operation or management of its franchise, from suppliers designated and approved by franchisor providing to the franchisee a complete list of such suppliers;

XII. Indication of what is in fact offered to the franchisee by the franchisor, with regard to:

(a) supervision of the chain;

(b) orientation service and other services rendered to the franchisee;

(c) training of the franchisee, specifying its duration, content and cost;

(d) training of the employees of the franchisee;

(e) franchise manuals;

(continued...)

information needed to satisfy the requirements.

Given the breadth of the Law, it would appear that a U.S. franchisor selling franchise rights (either by direct franchising or subfranchising) would be required to furnish a disclosure document.

d. Consequences of Violation

A franchisee who does not receive the required disclosures may request the annulment of the franchise agreement and the reimbursement of all amounts already paid to the franchisor or required to be paid to a third party, "plus damages."[63] It is not clear what additional damages may be involved, and it is not clear whether "amounts already paid" includes amounts paid for the purchase of equipment or inventory. A franchisor who provides false information may be liable for criminal sanctions as well as those described above.[64]

e. Exemptions and Exclusions

The Law does not contain any specific exemptions or exclusions. Also, the Law contains no provision for discretionary exemptions. Considering the breadth of many provisions of the Law, including jurisdiction, the definition of a franchise, and who is required to provide disclosure, franchisors are likely to find it difficult to avoid its application.

2. **France**

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[62](...continued)

(f) assistance on the analysis and selection of the location where the franchise will be established; and

(g) layout and architectural plans of the facility of the franchisee;

XIII. Status before the National Institute of Industrial Property (INPI) of the trademarks and patents which use will be authorized by the franchisor;

XIV. Situation of the franchisee after termination of the franchising agreement, regarding:

(a) know-how or industrial secret to which it may have access by means of the franchise;

(b) establishment of activities competitive with the franchisor;

XV. Model of standard franchising agreement and, if applicable also of standard preliminary franchising agreement used by the franchisor, with complete text, including its respective exhibits and expiration dates.

[63] *Id.* at art. 4.

[64] *Id*. at art. 7.

In 1989, France became the first country outside the United States to enact legislation requiring that franchisors supply prospective franchisees with pre-sale disclosure of information. The disclosure law, known as "Loi Doubin", was passed on December 31, 1989 ("Loi Doubin").[65] The Loi Doubin is extremely brief. In 1991, the French government issued regulations detailing its requirements in a decree ("Decree").[66] Together, the Loi Doubin and Decree describe the scope and nature of disclosure requirements in France. The French disclosure requirements apply to a far broader range of commercial relationships than are covered under the U.S. requirements, and the French law provides for no exemptions or exclusions.

a. Jurisdiction

The Loi Doubin applies to continental France and the French overseas departments. French law is territorial in nature and applies to any party, whether French, national or foreign national, involved in an agreement to be performed within France or in the French overseas departments. The French overseas departments are Guadeloupe (including St. Martin and the other islands in the Lesser Antilles), French Guyana, Martinique and Reunion. Any grant of franchise rights to be performed in this territory would be subject to disclosure requirements under the Loi Doubin. It is unclear, however, whether the Loi Doubin would apply to a French franchisor granting franchise rights to a foreign party to establish franchises in a non-French jurisdiction. Neither the Loi Doubin nor the Decree provide any specific exemptions or exclusions from assertion of jurisdiction.

b. Scope of the Law

Article I of the Loi Doubin begins as follows:

> Any person who puts at the disposal of another person a trade name, trademark or commercial symbol, while requiring from such other person an exclusive or quasi-exclusive undertaking for the conduct of such other person's business shall, prior to the signing of any such agreement, provide the other party with a document giving all necessary points of information to enable the other party to commit itself with knowledge of the relevant facts.

This definition encompasses contracts beyond franchise agreements: its broad statement of application would apply, for example, to other types of licensing contracts and dealership

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[65] Law. No. 89-100 of December 31, 1989, Relative To The Development of Commercial And Trade Enterprises And The Improvement Of Their Economic, Legal And Social Environment, Bus. Franchise Guide (CCH) ¶ 9,816.

[66] Decree of Implementing Regulations Applying Article I of Law No. 89-1008 of December 31, 1989, Bus. Franchise Guide (CCH) ¶ 9,816.

agreements. The use of the terms "exclusive and quasi-exclusive" without definition or explanation, further underscores its potentially broad reach. The use of such terms suggests a contractual obligation in which one of the parties (*e.g.*, the franchisee or licensee) either (i) obtains some form of "exclusivity" from the grantor, or perhaps (ii) agrees to limit its activities to those of the grantor, and not to engage in competitive activities. The Decree gives no clarification of this definition of a franchise. The broad and, in some cases, imprecise language of the Loi Doubin raises many questions as to the scope of its applicability, and the same can be said of the Decree.

c. Disclosure Requirements

The Loi Doubin requires that "the person who puts at the disposal of another" the right to use a trademark must provide disclosure. Accordingly, the franchisor is required to furnish the disclosure document to the prospective franchisee.

The Loi Doubin and the Decree do not address disclosure obligations in situations likely to arise for foreign franchisors. For example, a master franchisee (or sub-franchise) relationship is not addressed. In such event, it would appear that two levels of disclosure are required: first, that the franchisor provide disclosure to the master franchisee, and, second, that the sub-franchisor provide disclosure to the franchisee. In both cases it would appear that the "grantor" is putting the trademark use at the franchisee's disposal and requiring the "exclusive" or "quasi-exclusive" undertaking from the grantee.

The disclosure document must be delivered to the "other party" to the proposed franchise agreement or license agreement that receives the right to use the trademarks and assuming the "exclusive" or "quasi-exclusive" undertaking. The law does not specify whether franchisees renewing the franchise arrangements or transferees must receive disclosure.

Article I of the Loi Doubin requires that the disclosure document and the contract be provided at least twenty days prior to signing of the agreement or payment of monies, if applicable. Article 2 of the Decree varies slightly by providing only that the document and the disclosure information in the proposed agreement must be given to the other party at least twenty days prior to signing of the agreement. Notwithstanding the difference, it would appear that the Loi Doubin should be viewed as controlling.

While the Decree provides a brief list of the types of information about which disclosure must be furnished, the list is not specific as to the types of information included in each category and provides little guidance as to the scope of information required. The disclosure document must include all necessary information, but the franchisor may determine the format of the information presented in the disclosure document.

The document must contain information on the following four categories of information: the franchisor; the franchisor's network of licensees; a description of the market; and the terms of the license offered. In many respects, a U.S. style offering circular will contain the information

required by French law. However, in addition to information that would normally appear in a U.S. style offering circular relating to the franchisor, French law requires the franchisor's registration number on the Commercial Register and the Company's Register or Register of Independent Entrepreneurs Information relating to the trademark registration. It is not clear whether this means that a U.S. franchisor must obtain such a registration number. The franchisor must also include a description of the five major banks where the franchisor has accounts. What if the franchisor uses only banks that do not have offices in France? What if the franchisor has accounts at only one or two banks? Under the second category of required information, *i.e.* a description of the franchise network, the franchisor must indicate the date of execution or renewal of each franchise contract, in addition to the names and addresses of existing "members" of the franchisor's network. Finally, French law appears to contemplate a more extensive market survey than under U.S. disclosure laws.

d. Consequences of Violation

The Loi Doubin is administered and enforced by three ministers: the Minister of Justice, the Minister of Industry and National and Regional Development, and the Minister with Special Responsibility for Trade and Craft Industry. Penalties for failure to provide disclosure could include civil penalties of FF3,000 to FF12,000 or criminal penalties of between 1 and 2 months in jail. While there is no private right of action under Loi Doubin, a failure to comply would likely be brought to the attention of the French Ministry of Justice, which is the central government body responsible for prosecuting violations of the law. A franchisee has several options: the franchisee could bring a complaint before the Ministry of Justice, or could seek nullification of the agreement and damages through a civil action, if there is otherwise an adequate cause of action.

e. Exemptions and Exclusions

Unlike the disclosure laws in the United States, the Loi Doubin provides no exemptions or exclusions, and has no procedure for obtaining any form of discretionary exemption. Franchisors and master franchisees must provide disclosure, if the franchisor (i) grants trademark rights and (ii) obtains an "exclusive or quasi-exclusive undertaking" from the licensee. Given the breadth and the uncertain meaning of the requirement as to "exclusive or quasi-exclusive," it its difficult to identify any means to avoid furnishing disclosure under the Loi Doubin. The breadth of the coverage under the law means that very few franchise arrangements will be viewed as falling outside its scope.

3. Mexico

Mexico, like Brazil, for many years posed legal obstacles to foreign licensors seeking to enter the country. Throughout the 1970s and 1980s, Mexico was a country with high tariffs, extensive import restrictions, weak intellectual property law protection, and strict foreign investment restrictions. Under the old Mexican technology transfer law, for example, a trademark registered abroad could be used to identify goods manufactured in Mexico only if it

was joined with a trademark originally registered in Mexico. Trademark license agreements could be effective only if they were registered with the Registry of Transfer of Technology, which had a great deal of discretion. Moreover, post-term confidentiality requirements were not permitted. Although the purpose of the laws was more to protect the Mexican economy than to protect Mexican franchisees, the result was to stifle international licensing.

In recent years, however, Mexico has changed all this during the terms of Presidents de la Madrid and Salinas, with extensive changes in Mexican law and the entry of Mexico into GATT in 1986 and NAFTA in 1993. The legal changes included repealing the technology transfer law and enacting an entirely new Law for the Promotion and Protection of Industrial Property in 1991.[67] These changes, like those in Brazil, have made Mexico a much friendlier country for foreign franchisors, essentially allowing the parties the freedom to negotiate their own contracts. Mexican law no longer limits royalties or the conversion and expatriation of currency.

Also like Brazil, however, Mexico has recently imposed disclosure requirements for franchisors. The Mexican Law on Industrial Property, which includes the franchise law, became effective in 1991.[68] It requires disclosure and filing. The regulations implementing the law became effective on December 8, 1994.[69]

The Mexican law and regulations do not require registration of the offering circular with any Mexican authorities. Although the offering circular is not registered, Mexican law requires that all license agreements (including all franchise agreements) be filed with the Mexican Ministry of Commerce and Industrial Development.[70] The Ministry may deny the filing "for reasons of public interest."[71] This provision appears to give the Ministry a great deal of discretion. It is not at all clear what type of franchise agreement the Ministry might consider not to be in the "public interest". One specific basis for denying the filing is when the franchise agreement expressly excludes the applicability of the Mexican Law on Industrial Property. Franchisors may not avoid the Mexican law by a contractual provision excluding it. Nevertheless, the law allows the parties to provide in the agreement for international arbitration in the event of a conflict.

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[67] *See generally* J. B. McKnight and C. Müggenburg R.V., *Mexico's New Intellectual Property Regime: Improvements in the Protection of Industrial Property, Copyright, License, and Franchise Rights in Mexico*, 27 INT'L LAW. 27 (1993).

[68] Law on Industrial Property, Bill No. LD-5/90 (Iniciativa)-22/90, published in *Diario Oficial* June 27, 1991, effective June 28, 1991, Bus. Franchise Guide (CCH) ¶ 7210.

[69] Published in *Diario Oficial* Nov. 23, 1994, effective Dec. 8, 1994, Bus. Franchise Guide (CCH) ¶7215.

[70] Law on Industrial Property, Art. 143.

[71] Law on Industrial Property, Art. 150.

The regulations require the franchisor to file the franchise agreement with the Mexican Institute of Industrial Property when it is signed.[72] For purposes of this filing, an English language agreement must be translated into Spanish. All copies to be filed must follow the official format, all foreign signatures must be legalized, and the parties' domiciles and nationalities, and the term of the agreement, must be indicated in the agreement. The original, signed agreement or a certified copy of the signed agreement must be attached to the filing application. The franchisor may exclude from the agreement all references to royalties and other payments, and other confidential information.

a. Jurisdiction and Scope of the Law

Under the Mexican law, a franchise exists whenever, (i) in conjunction with a trademark license (ii) either technical knowledge is transmitted or technical assistance is furnished in order to enable the licensee to produce or sell goods or render services in a uniform manner, and (iii) where the operating, commercial, and administrative methods are established by the holder of the trademark and are aimed at maintaining the quality, prestige, and image of the products or services distinguished by the trademark.[73]

Any company that is a franchise under any U.S. franchise law is likely to be a franchise under Mexican law because the definition of a franchise is extremely broad under the Mexican law. Unlike most U.S. franchise laws, the definition of a franchise under the Mexican law does not include a fee element.

The Industrial Property Law does not appear to contain any further clarification of the extent of its jurisdiction, nor do the regulations. Clearly, however, any offer or sale of a franchise to a Mexican national who will have sales locations in Mexico will be within the jurisdiction of the Industrial Property Law. Presumably, the law will also apply if the sale is to a non-national for locations in Mexico. It is not clear whether the Industrial Property Law would apply to a U.S. franchisor granting franchise rights to a Mexican national for franchises outside of Mexico, nor is it clear whether the law would apply to a Mexican franchisor granting franchise rights to a foreign party to establish franchises outside of Mexico.

b. Disclosure Requirements

The law requires the franchisor to make the required disclosures to each prospective franchisee prior to the execution of a franchise agreement.[74] In addition to information that is required in U.S. disclosure documents, the Mexican regulations specifically require that the

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[72] Regulations, Art. 10.

[73] Law on Industrial Property, Art. 142.

[74] *Id.*

disclosure document include the franchisor's domicile and nationality, and the amount of time the franchisor and any master franchisee have operated the business.[75]

c. Consequences of Violation

Failure to comply with the disclosure requirements may subject a franchisor to fines, temporary or permanent closing of the business, and arrest for up to 36 hours.[76] A franchisee damaged by the franchisor's noncompliance with the disclosure requirements may also bring private lawsuit against the franchisor.[77] The franchisee may seek a declaration invalidating the franchise agreement and recovery of damages. Noncompliance with the filing requirement, however, will not affect the validity of the franchise agreement.

Trademark infringement and misappropriation of trade secrets are crimes in Mexico,[78] punishable by two to six years' imprisonment and fines. The damaged party may also bring a private lawsuit for damages.[79]

d. Exemptions and Exclusions

As in Brazil and France, the Mexican Industrial Property Law does not contain any specific exemptions or exclusions, and has no procedure for obtaining any form of discretionary exemption. Accordingly, franchisors seeking to expand into Mexico are likely to have to comply with the requirements of the Industrial Property Law.

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[75] Article 65 of the regulations requires that franchisors provide prospective franchisees with the following information: "(i) name, trade name or business name, domicile and nationality of the franchisor; (ii) description of the franchise; (iii) amount of time the original franchisor company and, as applicable, the master franchise has been in the business under the franchise; (iv) intellectual property rights involved in the franchise; (v) amounts and types of payment that the franchisee is to pay to the franchisor; (vi) types of technical assistance and services that the franchisor is to provide to the franchisee; (vii) definition of the territorial operating zone of the place of business that exploits the franchise; (viii) whether the franchisee has the right to confer subfranchises to third parties and, as applicable, the requirements to be covered in order to do so; (ix) obligations of the franchisee regarding confidential information provided by the franchisor; and (x) in general, the obligations and rights of the franchisee derived from the franchise contract."

[76] Law on Industrial Property, Art. 214.

[77] Law on Industrial Property, Art. 221.

[78] Law on Industrial Property, Art. 223.

[79] Law on Industrial Property, Art. 226.

4. **Alberta, Canada**

Alberta is the only province in Canada that has a franchise law. Canada has no national franchise law. The Alberta Franchises Act, which has been in effect since 1980, requires franchisors to register franchise offerings and to make disclosures, much as several U.S. states do.

In late 1994, the provinces of Alberta and Ontario established committees of government, franchisor and franchisee representatives to consider franchising legislation. The Alberta Committee released a proposal for a new Franchises Act in February, 1995, which was later introduced into the Alberta legislature and passed on May 16, 1995.[80] The Act will go into effect when the regulations are promulgated and the Act receives royal assent. This may happen by the time this paper is published. It is generally anticipated that the use of the UFOC format will be permitted, with certain modifications, as it is under the current law.

This discussion of the new Alberta Franchises Act is based only on the Act itself. A full discussion of the practical effects of the new Act, including considerations on how a franchisor might avoid the application of the Act, will not be possible until the regulations are promulgated.

The new Franchises Act eliminates the current law's registration requirement, but continues to require disclosure to prospective franchisees. The content of the required disclosures will be set forth in the regulations. Unlike the current law, there will be no requirement to register sales persons.

In addition to the disclosure requirements, the Act provides as follows: "Every franchise agreement imposes on each party a duty of fair dealing in its performance and enforcement."[81] The Act also requires franchisors to permit franchisees to form organizations of franchisees.[82] These "relationship" obligations, including the fair dealing obligation, will apply not only to new franchise sales, but also to franchise sales made before the Act comes into force.[83] The Act also provides a mechanism by which the state may designate one or more bodies to govern franchising and promote fair dealing among franchisors and franchisees.[84]

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[80] 1995 Bill 33 of The Legislative Assembly of Alberta.

[81] Section 7.

[82] Section 8.

[83] Section 3(2).

[84] Section 21.

It is generally expected that the Ontario Committee will recommend legislation similar to the Alberta Franchises Act, although no such recommendation was yet made at the time this paper is going to press.

a. Jurisdiction

The Alberta Franchises Act will apply to the sale of a franchise made on or after the Act comes into force:

(a) if the franchised business is to be operated either partly or wholly in Alberta, and

(b) if the purchaser of the franchise is an Alberta resident or has a permanent establishment in Alberta for the purposes of the *Alberta Corporate Tax Act.*[85]

The Act provides that the law of Alberta applies to franchise agreements.[86] Any provision in a franchise agreement restricting the application of the law of Alberta or restricting jurisdiction or venue to any forum outside Alberta is void with respect to a claim otherwise enforceable under the Act in Alberta.[87] Moreover, any waiver by the franchisee of any right or requirement of the Act or the regulations is void.[88]

b. Scope of the Law

The term "franchise" is defined under the Act[89] to mean a right to engage in a business:

(i) in which goods or services are sold or offered for sale or are distributed under a marketing or business plan prescribed in substantial part by the franchisor or its associate;

(ii) that is substantially associated with a trademark, service mark, trade name, logotype or advertising of the franchisor or its associate or designating the franchisor or its associate; and

[85] Section 3(1).

[86] Section 16.

[87] Section 17.

[88] Section 18.

[89] Section 1(1)(d).

(iii) that involves:

(A) a continuing financial obligation to the franchisor or its associate by the franchisee and significant continuing operational controls by the franchisor or its associate in the operations of the franchised business, or

(B) the payment of a franchise fee.

A "franchise" is defined to include a master franchise and a subfranchise arrangement. A franchise fee does not include the payment of a fully refundable deposit,[90] nor does it include a purchase of a reasonable amount of goods or services at a reasonable bona fide wholesale price.[91]

c. Disclosure Requirements

Under the Act, a franchisor must give each prospective franchisee a copy of the disclosure document at least fourteen days before the signing by the prospective franchisee of any agreement relating to the franchise or the payment of any consideration relating to the franchise, whichever is earlier.[92]

The required contents of the disclosure document will be set forth in the regulations. In any event, the disclosure document must contain copies of all proposed franchise agreements and financial statements.[93]

d. Consequences of Violation

A franchisee who suffers a loss because of a misrepresentation contained in a disclosure document has a right of action for damages against the franchisor and every person who signed the disclosure document.[94] A franchisee who purchases a franchise is deemed under the Act to have relied on any misrepresentation contained in a disclosure document relating to that fran-

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[90] Section 4(6).

[91] Section 1(1)(f).

[92] Section 4(2).

[93] Section 4(3).

[94] Section 9(1).

chise.[95] Defenses to liability include proof that the franchisee purchased the franchise with knowledge of the misrepresentation.[96]

If a franchisor fails to give a prospective franchisee the disclosure document by the required time, the franchisee may rescind the franchise agreement within two years after the franchise is granted, or within sixty days after receiving the disclosure document, whichever occurs first.[97] In other words, the right to rescind for failure to make disclosure lasts for no more than two years. The franchisor may cure the failure by giving the franchisee a disclosure document before the two years have elapsed, and allowing the franchisee sixty days to rescind.

The Act also authorizes the Lieutenant Governor in Council to designate one or more bodies "to govern franchising and to promote fair dealing among franchisors and franchisees."[98]

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[95] Section 9(2).

[96] Section 10(1).

[97] Section 13.

[98] Section 21(1).

e. Exemptions and Exclusions

The Act exempts the following franchise sales from the disclosure requirements:[99]

- a sale by a franchisee for the franchisee's own account, where the sale is not effected by or through the franchisor;
- a sale to a person who has been an officer or director of the franchisor for at least six months;
- the sale of an additional franchise to an existing franchisee if the additional franchise is substantially the same as the existing franchise;
- a renewal or extension of an existing franchise agreement;
- the sale of a franchise for a total annual investment below an amount to be prescribed by regulation;
- a sale by an executor, administrator, receiver, trustee, trustee in bankruptcy or guardian;
- the sale of a right to sell goods in a department or division of a retail establishment, if the person is not required to purchase goods or services from the operator of the retail establishment;
- the sale of a fractional franchise, to be defined in the regulations.

The Minister may make additional exemptions by regulation.[100] The burden of proving an exemption or exclusion is on the person claiming it.[101] Exemptions under the Alberta Franchises Act of 1980 will continue until they expire as stated in the orders giving the exemptions.[102]

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[99] Section 5(1).

[100] Section 6(1).

[101] Section 19.

[102] Section 22(4).

5. **Australia**

In 1993, Australia became the third country to implement a national "requirement" that a franchisor provide pre-sale disclosure to prospective franchisees.[103] After failed attempts to pass franchise legislation in the past, Australia adopted the Franchising Code of Practice ("Code") on August 24, 1993.[104] The Code is distinctive in that it is "voluntary." As a practical matter, many franchisors operating in Australia have complied with it. On March 7, 1995, the Federal Minister for Small Business, Customs, and Construction in Australia released an independent review of the Code, proposing changes to improve coverage, compliance, disclosure, and standards of conduct and a system of co-regulation under Australia's Corporations Regulations.[105]

a. Franchise Defined

The definition of franchise used by the Code is a broadly worded provision that encompasses many kinds of commercial relationships. The Code defines a franchise as:

> a contract, agreement or arrangement, whether express or implied, whether written or oral, between two or more persons (such contract, agreement, or arrangement hereinafter called the "Franchise Agreement"); by which a party to the Franchise Agreement (hereinafter called the "Franchisor") authorizes or permits the other party to the Franchise Agreement (hereinafter called the "Franchisee") the right to engage in the business of offering, selling or distributing goods or services within Australia and such Franchise Agreement contains at least the following obligations or provisions:
>
> - the Franchisor grants to the Franchisee the right to the use of a mark, in such a manner that the business carried on by the Franchisee is or is capable of being identified by the public as being substantially associated with a mark identifying, commonly connected with, or controlled by, the Franchisor;
> - the Franchisee is required to conduct the business, or that part of the business subject to the Franchise Agreement, in accordance with the marketing, business, or technical plan or system specified by the Franchisor; and

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[103] The United States and France were the first two.

[104] Bus. Franchise Guide (CCH) ¶ 10,298 (1992-93 Transfer Binder).

[105] Bus. Franchise Guide (CCH) ¶ 7308.

- the Franchisor provides ongoing marketing, business or technical assistance during the life of the Franchise Agreement.[106]

In addition, an arrangement not meeting the Code's definition might also be considered a franchise if either of the parties involved designates the arrangement as a franchise or the arrangement is within the definition of a franchise under the Petroleum Retail Marketing Franchise Act of 1980.[107]

A few important aspects of the definition should be noted. First, the definition requires that the arrangement involve a license to use a mark, whether it is registered or not. The mark must be substantially identified with the franchisee's business. This requirement may include all but the most pure distributorship arrangements. There is no limit or explanation of the requirement that the franchisee conduct the franchised business in accordance with the franchisor's plan or system. Presumably any type of plan or system of the franchisor used by the franchisee to conduct the business would satisfy this element. This is also true for the last element of the definition that the franchisor must provide marketing, business, or technical assistance. Even minimal advice might bring an arrangement within the meaning of "franchise" used by the Code.

The definition appears to apply to a broad array of commercial relationships. The Code contains no mechanisms to resolve whether a particular arrangement falls within the definition of a franchise. Franchisors are left to determine for themselves whether the particular arrangement falls under the franchise definition and disclosure requirements of the Code.

The Code also defines a Master Franchise as follows:

> Master Franchise means a Franchise in which the Franchisor grants another person (called the Master Franchisee or Sub-Franchisor) the rights to sub-franchise to other persons ("the Franchisees") the Marks and Franchise System of the Franchisor.[108]

b. Disclosure Requirements

The Code requires all registered franchisors to make disclosure. If a franchisor elects to comply with the Code, it must register with the administering body, the Franchising Code Administration Council Ltd. ("Council"). By registering, a franchisor agrees to provide the required disclosure to prospective franchisees. In the case of a three-way contract (franchisor,

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[106] Franchising Code of Practice, Section 3.1(a).

[107] Robin Vague et al., *Pre-Sale Franchise Disclosure: A Review of the Disclosure "Requirements in Australia*, 8 J. INT'L FRANCHISING & DISTRIBUTION L. 118, 119 (1994).

[108] Franchising Code of Practice, Section 3.1(i).

master franchisor, and franchisee), the Australian Franchising Task Force recommended that disclosure should be made by both the franchisor and subfranchisor, including financial disclosure relating to both.[109]

Australian franchisors selling franchises to residents outside Australia need not provide disclosure if the franchise will be operated outside of Australia.[110] Non-Australian franchisors granting several master franchises in Australia are governed by the Code.[111]

The Code directs franchisors to provide disclosure to all prospective franchisees. Although the term is undefined, the term "prospective franchisees" probably includes all those who are about to sign a franchise agreement. There is no requirement that prospective franchisees be given disclosure prior to payment of any money. In addition, franchisors must make disclosure to franchisees on renewal of their franchise agreement and to any existing franchisee upon request. The Code is silent regarding disclosure in transfer situations. Advisors must provide to their clients and prospective clients all required disclosure that relates to them.

Disclosure must be provided seven days prior to executing the franchise agreement. Franchisors are also required to make disclosure to existing franchisees upon request, which presumably can be made at any time during the term of the franchise agreement.

The disclosure requirement of the Code mandates that franchisors supply three items: a disclosure document, a copy of the Code, and a published guide for franchisees approved by the Council.[112] The disclosure document must include information on twelve categories of information specified in the Code. In addition to the information that a franchisor would be required to provide for a U.S. franchise sale, the Australian Code requires the offering circular to include a statement whether the franchisor is a member of the Franchisor's Association of Australia and New Zealand; the names, job descriptions, and qualifications of the franchisor's directors, executive officers, or principals; a detailed resume of the business experience of the franchisor and its related entities, directors and officers; if there was a former franchisee in the territory, the history and details of the former franchisee; and the franchisor's Code registration number and an advisory note to franchisees (warning them to study the contract), and a general disclaimer statement (that the Council accepts no responsibility for disclosure document and the information contained in it).

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[109] William D. Thompson, *Franchising in Australia*, 1993 IBA/IFA ANNUAL JOINT INTERNATIONAL SEMINAR ON INTERNATIONAL FRANCHISING.

[110] Franchising Code of Practice, Section 3.3.

[111] The sale of a single master franchise in Australia is exempt, as discussed below.

[112] The only such guide in existence is "Franchisee's Guide" published by Franchisor's Association of Australia and New Zealand.

Vendors and advisors are also required to disclose information. Vendors are required by the Code to provide financial disclosure, including copies of last three fiscal years' trading/profit and loss statements and auditor's reports. Advisors must provide a profile of the individuals, true representations as to their franchising education and experience, and disclose any matter which may create a conflict of interest in respect to a client.

c. Consequences of Violation

The Code is administered by the Council, whose responsibilities include reviewing and amending the terms of Code, recommending revisions, establishing the register of persons agreeing to comply with the Code, and deregistering those who do not. Because the Code is voluntary, there are no civil or criminal penalties for noncompliance. Rather, revocation of registration and being named in the Council's annual report are the only sanctions available to the Council.[113]

In order to remove a franchisor from the register, the Council must first have reason to believe or has received advice or information that a franchisor is not complying with the Code. The Council then notifies the franchisor of its opportunity to show cause why it should not be removed from register, and provides an opportunity to respond. If the franchisor is removed and disagrees with subcommittee decision, it can appeal to the full Council. Once the franchisor is removed from register, it may reapply for registration after 6 months from removal. But the franchisor must demonstrate in its reapplication that it is prepared and able to comply with Code.

Finally, it is possible that a franchisee could utilize statutory or common law remedies under the Trade Practices Act as a basis for a legal action against a franchisor that had not sufficiently complied with the Code.[114]

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[113] The Code contains certain provisions that place commercial pressures on individuals to register. Under the Code, registered banks or financial institutions agree that they will only provide customized franchise finance/service packages for the franchised systems of registered franchisors. Also, registered publishers and advertising media agree that, in connection with franchise opportunity advertisements, they will ensure advertising complies with the Code and will separate the advertising of registered and non-registered franchisors. Franchising Code of Practice, Section 16.

[114] *See, e.g.,* Vague et al., *supra* note 99; Thompson, *supra* note 101.

d. Exemptions and Exclusions

The Code contains a standard exemption for overseas franchisors selling a single master franchise in Australia. However, if the franchisor later sells other franchises within two years of the initial master franchise sale, the franchisor must comply with the Code. There are no other standard exemptions. However, the Council has the authority to exempt certain specific arrangements or systems from full or partial compliance with the Code, where such compliance "would be inappropriate due to the nature of the arrangements or systems."

Given the breadth of the Code's definition of a "franchise," there is relatively little room for franchisors in Australia to escape its scope. By American standards the required disclosure is relatively mild. Of course, as long as the Code remains voluntary, the simplest means would be simply not to comply. If a non-Australian franchisor wishes to comply, the sale of one master franchise to a master franchisee for the entire country would exempt the U.S. franchisor from disclosure to the master franchisee. It would not, however, exempt the master franchisee from its disclosure obligations. Clearly, a U.S. franchisor should obligate its foreign master franchisee to comply with its disclosure obligations and to furnish the franchisor with such disclosure for its approval as to accuracy and completeness.

III. OTHER LAWS AFFECTING INTERNATIONAL FRANCHISING

A. U.S. STATE FRANCHISE RELATIONSHIP LAWS

A U.S. franchisor venturing abroad must also consider the possible effect of franchise relationship laws. As discussed above, the new Alberta Franchises Act contains provisions affecting the relationship between franchisors and franchisees. Among other things, the new law includes a duty of fair dealing on the part of all franchisors.

Several U.S. states also have franchise relationship laws, and these laws might potentially apply to franchises outside of the state. Although the authors have not found an a case in which U.S. state franchise relationship laws have applied to agreements between U.S. and non-U.S. parties, some case law suggests that such application is possible.

A U.S. franchisor, for example, might enter into a master franchise agreement granting to a company with offices in New Jersey the right to open franchises and subfranchise in a country other than the U.S. In such case, it is possible that the New Jersey Franchise Practices Act (the "NJFPA")[115] may come into play, requiring the franchisor to have good cause before terminating or refusing to renew the master franchise agreement. The extraterritorial application of the NJFPA under comparable facts was illustrated in the case of *Instructional Systems, Inc. v.*

[115] N.J. Rev. Stat. §§ 56:10-1 through 56:10-12.

Computer Curriculum Corp.[116] In that case, the New Jersey Supreme Court held that the NJFPA applied to a nonrenewal of the franchise agreement for parts of the franchisee's territory outside of the state of New Jersey, even though the contract called for the application of California law.[117]

A U.S. franchisor based in New Jersey must also be careful not to choose New Jersey law to govern the agreement. In *Dep't of Motor Vehicles v. Mercedes-Benz,*[118] a Florida court held that the NJFPA applied where the agreement called for the application of New Jersey law, even though the franchisee and the franchised business were in Florida. The court ruled that the contractual choice of New Jersey law evidenced an intent that the NJFPA should apply.

Both the *Mercedes-Benz* and *Instructional Systems* cases are exceptional. In most cases, courts will not apply the franchise relationship law of a state in which the franchisee is *not* located, since these laws are generally intended to apply only to franchise business located within the state. Most of the state franchise relationship laws specifically apply when the franchisee has a place of business within the state.[119] Therefore, even applying these laws would not afford protection to the out-of-state franchisee in most cases.

In *Premier Wine & Spirits v. Gallo*,[120] a federal district court in California held that the California Franchise Relations Act did not apply where the franchisee was not domiciled in California and the franchised business was not operated in California, notwithstanding the choice

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[116] No. 93-5414 (3d Cir. Sept. 16, 1994) (slip opinion), *cert. denied,* 63 U.S.L.W. 3477 (February 21, 1995). *See* Thomas M. Pitegoff, *Choice of Law in Franchise Relationships: Staying Within Bounds*, 14 FRANCHISE L.J. 89 (1995).

[117] 130 N.J. 324, 614 A.2d 124; Bus. Franchise Guide (CCH) ¶ 10,119 (NJ 1992). Similarly, in *Wright-Moore Corp. v. Ricoh Corp.*, 908 F.2d 128, Bus. Franchise Guide (CCH) ¶9665 (7th Cir. 1990) the court held that the Indiana Franchise Practices Act applied to the nonrenewal of an agreement with a national distributor based in Indiana although the contract called for the application of New York law.

[118] 408 So.2d 627 (Fla. 1981), modified 455 So.2d 404 (Fla. 1984), pet. for rev. den. 462 So.2d 1107 (Fla. 1985).

[119] Ark. Stat. Ann. §4-72-203; Cal. Bus. & Prof. Code §20015; Conn. Gen. Stat. §42-133h; Del. Code Ann. §2551(1); Ill. Laws of 1987, Ch. 85-551, §§18, 19 & 20; Ind. Code, Title 23, Art. 2, Ch. 27, §2; Missouri Rev. Stat. §407.400; Neb. Rev. Stat. §87-403; N.J. Rev. Stat. §56:10-4; Va. Code §13.1-559; Wis. Stat. Ann. §135.02(2). The Indiana and Minnesota franchise relationship laws will also apply if the franchisee is merely a resident of the state. Ind. Code, Title 23, Art. 2, Ch. 27, §2; Minn. Stat. 1986 §80C.19. The franchise relationship laws of Hawaii, Michigan, Mississippi and Washington are silent regarding territorial reach.

[120] 644 F. Supp. 1431 (E.D. Cal. 1986), aff'd 846 F.2d 537 (9th Cir. 1988).

of California law.[121] In *Bimel-Walroth v. Raytheon*,[122] the court held that the Wisconsin Fair Dealership Law did not apply when the dealer was out of state, notwithstanding the contractual choice of Wisconsin law.

B. EUROPEAN COMMUNITY ANTITRUST LAW

Article 85(1) of the Treaty of Rome, the document which established the European Economic Community, prohibits agreements that restrict trade among member states of the EEC. Article 85(1) prohibits all agreements "which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market ...." This provision is commonly viewed as the "antitrust" provision of the Treaty of Rome.

Article 85(3) allows for the granting of individual exemptions or block exemptions for agreements that contribute to improving the production or distribution of goods or to promoting technical or economic progress while allowing consumers a fair share of the benefits.[123] Under Article 85(3), the Commission can also give negative clearance on the grounds that the prohibition of Article 85(1) is not applicable.

In 1967, the Commission of the European Communities issued a block exemption for exclusive dealing contracts.[124] In the 1986 case of *Pronuptia de Paris GmbH v. Irmgard Schi-gallis,*[125] a franchisee of wedding dress stores objected to its obligation to pay arrears on royalties invoking Article 85(1) of the Treaty of Rome. The Court of Justice of the European Communities held that exclusive territories in franchise agreements violated Article 85(1) of the

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[121] *See also* Gilchrist Machinery v. Komatsu, 601 F. Supp. 1192 (S.D. Miss. 1984); S & R v. Nissan, Bus. Fran. Guide (CCH) ¶8146 (D. Md. 1984).

[122] 796 F.2d 840 (6th Cir. 1986).

[123] Article 85(3) provides that the provisions of paragraph 1 may be declared inapplicable in the case of any agreement category of agreements

> "which contributes to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which does not:
> (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives;
> (b) afford such undertakings the possibility of eliminated competition in respect of a substantial part of the products in question."

[124] Regulation No. 67/67, March 22, 1967.

[125] Case 161/84, 1986, ECR 353, Bus. Franchise Guide (CCH) ¶8569.

Treaty of Rome. The court held that the 1967 regulation exempting exclusive dealing contracts did not apply to franchise agreements. That exemption applied to contracts for the exclusive supply or purchase of goods for resale, in distinction to a contract also requiring the use of a trademark, uniform business methods, and the payment of royalties.

In response to the *Pronuptia* decision, the Commission of the European Communities adopted a block exemption regulation for franchise agreements in 1988.[126] The regulation, which went into effect on February 1, 1989, applies both to franchise agreements and to master franchise agreements. It specifically permits many of the restrictions that are typical in franchise agreements. Franchisors that seek to fall within the scope of the exemption, however, must carefully analyze their franchise agreement in light of the requirements of the exemption. If the franchise agreement contains restrictions not listed in the exemption, the offending restrictions should be revised in accordance with the block exemption. Otherwise, it may be advisable to seek an individual exemption. As long as the notification to the Commission requesting the individual exemption expressly refers to the block exemption, the Commission has only six months to object.[127]

C. LAWS RESTRICTING THE FRANCHISEE BASED ON NATIONALITY

Other foreign laws restrict international transactions, as well. A number of countries, for example, impose specific limitations on the involvement by foreigners in their local economy. Such restrictions typically take one of two forms: (i) foreign investment laws restricting the foreign ownership of any kind of business, and (ii) laws restricting foreign operation of, or ownership in, specific types of businesses or industries.

A restriction common to a number of countries requires non-nationals to obtain government approval of any investment by foreign nationals. While some countries provide routine approval to applications for foreign investment,[128] others scrutinize such transactions more carefully.[129] Other types of approval are sometimes required. In certain countries (e.g., in

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[126] Regulation No. 4087/88, November 30, 1988, 1988 O.J. (L 359) 46.

[127] *See* Article 6 of the regulation.

[128] New Zealand requires approval for ownership activities by an "overseas" person," but most applications are approved. Loewinger, *supra* note 2, at 3.

[129] Malaysia requires approval for all foreign investment, with all approvals and licenses coordinated through the Malaysian Industrial Development Authority. Industrial Coordination Act (1975).

Indonesia and the Philippines), the government must approve the incorporation of any company by non-nationals.[130]

The second category of nationality-related restrictions involves industry-related restrictions. Typically, these types of laws bar foreigners from owning or operating certain categories of businesses. For example, the Indonesian government specifies certain industries in which foreign investment is prohibited or restricted; presumably, all other sectors not specified are open for non-national investors.[131] In Thailand foreign participation is prohibited in the restaurant business, and in the Philippines, foreign participation in retail activities has traditionally been closed to non-nationals. In Brazil, foreign investment in some activities, including mining, telecommunication, media, domestic-vessel transportation, and computer industry, is either directly prohibited or restricted to a certain amount of minority interest.[132] Other countries impose indirect limitations on foreign investment, such as Taiwan, which restricts the management and employees of foreign-owned business.

Franchisors franchising overseas must examine the scope and application of such nationality-based restrictions to determine if they provide obstacles to the franchisor's planned foreign operations. If such laws do pose obstacles, it is necessary to determine whether there are any available exemptions or exclusions. In certain cases, such exemptions may be available by treaty. For example, because of exemptions contained in the U.S.-Thailand Treaty of Amity and Economic Relations, American companies are exempt from restrictions on non-nationals participating in restaurant businesses in that country.

Restrictions on nationality may affect the structure of the transaction and the selection of the master franchisee or developer within a particular country. Frequently a franchisor will engage in extensive discussions with a foreign party only to discover that the laws of a foreign country prohibit investment by that party or operation of the business to be franchised.

In countries where such restrictions exist, a master franchise arrangement may be used to effectuate the transaction and to avoid such laws, even if a non-national of the host country is to be licensed. The non-national master franchisee might, for example, either (i) determine whether some means exists under local country law to operate in the host country, or (ii) identify and franchise a national of the host country to operate the franchise business. If direct franchising is to be used, it may be difficult for the franchisor and developer to avoid the restrictions of such

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[130] Hornick and Nelson, *Foreign Investment in Indonesia*, 11 FORDHAM INT'L L.J. 724, 727-28 (1988); Sayoc, *Philippines, in* SURVEY OF FOREIGN LAWS AND REGULATIONS AFFECTING INTERNATIONAL FRANCHISING (P. Zeidman, ed., 2nd. ed. 1990)

[131] Indonesia traditionally has restricted foreign ownership of restaurant businesses. This provides a big impediment to franchisors in the fast food business. Loewinger, *supra* note 2, at 4.

[132] SURVEY OF FOREIGN LAWS, *supra* note 122, at 11.

laws. In any case, exceptions to the nationality requirements do exist, and these should be explored. For example, alternative ownership arrangements sometimes exist under a country's foreign investment laws -- *e.g.*, through taking a minority ownership interest; through a joint venture arrangement; or through corporate shareholding devices.

D. TECHNOLOGY TRANSFER LAWS

Although Brazil and Mexico have changed their laws in recent years to allow for far easier entry into their markets by foreign investors, licensors and franchisors, many other countries in the world continue to have restrictive, nationalistic, technology transfer laws that pose a real obstacle to foreign franchisors. These laws typically require that an agreement licensing foreign trademarks and other intellectual property be registered in the technology office of the licensee's country, which closely inspects all license agreements with foreign licensors. The technology office may have the power to require changes in the business terms of the agreement, such as limiting the term of the agreement or the amount of royalties, and also in the legal terms, such as prohibiting any restrictions on the licensee's post-term use of the trade secret information furnished by the licensor to the licensee. Such technology offices also typically have the power to refuse to register the agreement.

A number of countries contain technology transfer laws with broad restrictions. For example, in the Pacific Rim, the Peoples' Republic of China, the Philippines, South Korea, and Taiwan all have laws with such restrictions. The technology transfer laws in the Philippines, South Korea and Taiwan all restrict royalty payments and the term of the agreement.[133]

Typically, such laws will reach any transaction to be performed within the host country, and only limited exemptions and exclusions of limited utility to franchisors exist. One way a U.S. franchisor might minimize its registration obligations under these laws would be to have only one agreement that requires registration. A U.S. franchisor will frequently enter into both an area development agreement, which contains the development obligations, and separate franchise agreements for each franchise location. By putting all of these obligations in one agreement, a franchisor will only have to deal will one registration obligation.

As a practical matter, where local law requires that the agreement be filed with a government agency, it is usually advisable for the U.S. franchisor to take responsibility for this filing through its own attorneys. This gives the franchisor the ability to negotiate with the government agency through the franchisor's attorney, rather than relying on the franchisee, who may rely on the local country restrictions to bargain for terms and conditions that are in the franchisee's interest. It is advisable to reflect in the contract the fact that the franchisor will handle the registration.

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[133] *See* INTERNATIONAL FRANCHISING LAW (Dennis Campbell, ed., 1993), for a discussion of other countries with technology transfer laws (*e.g.,* Malaysia, Nigeria, South Africa and Venezuela).

Where the royalty permitted by the government under the license agreement is too small to justify the license from the franchisor's point of view, the franchisor may decide to require payment of a second fee under a separate technical assistance agreement. This agreement may also require government approval. One problem is that the local authorities in some countries view such a technical assistance agreement as a one-time transfer of technology. Upon the expiration of the agreement, the U.S. company may be required to show that new technology is being provided in order to justify renewal.

Another way of dealing with royalty restrictions might be to enter into a second agreement with the franchisee to make up the shortfall. Such an agreement might be possible if the franchisee has an affiliate outside of the country that imposes this royalty restriction. The U.S. franchisor must be mindful of the requirements of the local law and work closely with local counsel to be sure that any such arrangement will be enforceable and will not contravene local law.

Still another way of dealing with royalty restrictions may exist where a franchisor sells product to the franchisee in connection with the grant of franchise rights. In such situations the franchisor may enter into a separate product distribution agreement with the developer or master franchisee. Such arrangements will frequently not be deemed to be technology transfer arrangements if there are no trademarks, or technical or trade secret information being licensed. As a result, the royalty may be built into the price of the product, and will not be subject to government approval. It may, however, be subject to tariff rates and may therefore be at a higher cost to the master franchisee or developer.

In some countries, the technology transfer laws make contractual restrictions on exports from the licensee's country unlawful. This can pose a problem for any licensor that grants an exclusive license to another company in another country. One solution that may be accepted by the local authorities is to provide in the agreement that the local company may export anywhere in the world except to countries in which the licensor has granted exclusive rights to others.

E. EXCHANGE CONTROL LAWS

Exchange control legislation exists in a number of countries. The purpose of such laws is to permit governmental authorities to regulate payments in foreign or "hard" currency outside of the country to non-nationals of such countries. Frequently, a central bank of the country will administer exchange control regulations. The purpose of such legislation is to avoid depletion of valuable hard currency and to minimize consumption of foreign consumer goods to conserve monies for domestic investment deemed necessary for economic growth. In such cases, the central bank may limit the amount that may be paid in U.S. dollars.

Exchange control laws are frequently broad in scope and apply to any commercial transactions occurring in or relating to the host country and, in many cases, the nationals of such country. Depending on the stringency of the exchange controls being applied, and the foreign currency reserves of the country, there may be exemptions for minimal payments. Such

exemptions are rare, however, in countries that have severe foreign exchange problems. As a result, there are typically few explicit exemptions or exclusions available to avoid such laws. Nonetheless, there are several techniques that may be used to deal with these laws.

One technique for dealing with these laws is to determine whether one of the principals or affiliates of the foreign master franchisee or developer has substantial assets outside of, and arguably beyond the jurisdiction of, the host country imposing the restriction. If so, the franchisor can seek to arrange for offshore payment from one of the principals of the foreign master franchisee or developer, either through an "offshore agreement" or a guarantee. Typically, the law would not impose the exchange control restriction on a U.S. franchisor. Instead, it is likely to be the responsibility of the foreign party making the payment who will be subject to such restriction and who will be responsible for compliance, depending on the particulars of the law and the facts.

A second technique used when severe restrictions exist or if the currency is simply not convertible into U.S. dollars is for the U.S. franchisor to receive payment in the local currency and invest it locally until a later date when the law might change, or to negotiate a barter or countertrade arrangement in order to receive payment abroad. Close consultation with counsel will be necessary in order to ensure that any proposed arrangement does not violate applicable law.

F. AGENCY LAWS

Many countries have laws that protect local agents, licensees and distributors from wrongful termination. These laws may require the franchisor to have good cause to terminate or fail to renew, regardless of what the contract provides. Just like the dealership or franchise relationship laws in Puerto Rico, New Jersey, Wisconsin and elsewhere, the laws of some countries require that the supplier or licensor have good cause to terminate or fail to renew the agreement. Failure to comply with such laws may give the local franchisee a right to an "indemnity", which is compensation that might include lost profits, capital expenditures and goodwill. In order to minimize the effects of these laws, the U.S. franchisor may want to consider a short, fixed term agreement. The agreement should also clearly define what constitutes cause for termination.

What U.S. lawyers call sales representatives are referred to in many countries as agents. In some countries, agents enjoy protection against termination that distributors do not have. If a distribution agreement calls for very close direction by the supplier, the distributor may seek in litigation to have the agreement recharacterized as an agency or employment agreement. Employees in many countries enjoy far greater protection than they do in the U.S.

Agency laws vary widely from country to country. For example, while countries with state controlled economies may severely restrict the use of agents, others permit the use of agents, and still others require the use of local agents for government purchases.[134]

IV. CONCLUSION

A complicated web of laws and regulations governs international franchising. We have sought to identify and address some of the areas of particular concern for U.S. franchisors venturing abroad, and we hope we have made some practical suggestions. It should be clear that, in each particular transaction, both U.S. and foreign counsel must analyze carefully what laws apply, and all practicable approaches to address them.

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[134] *See generally* Paul Homsy, *Agency Law in the Arabian Peninsula and North Africa,* 5 Northwestern J. of Int'l Law & Bus. 296 (1983).

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