Guiding You Through the Legal Maze.SM

FRANCHISING INTERNATIONALLY

Kanouse & Walker, P.A.
One Boca Place, Suite 324 Atrium
2255 Glades Road
Boca Raton, Florida 33431
Telephone: (561) 451-8090
Fax: (561) 451-8089
E-mail: Keith@Kanouse.com

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I. THE BURGEONING GLOBAL MARKETPLACE

As established United States franchisors begin to saturate the U.S. market and as improvements in transportation and telecommunications make the world seem increasingly smaller, and with fewer trade barriers and people from other countries desiring the products and services offered by U.S. companies, U.S. franchisors are going international in increasing numbers. The number of U.S. franchise systems with foreign units has grown from 156 in 1971 to 397 in 1989 (17% of all U.S. business format franchisors) with the number of foreign units increasing from 3,365 to over 37,654 during the same period. In addition, domestic product and business format franchisors are now operating in over 160 countries. (*Franchising in the Economy* 1991, p. 1). Currently, over 400 U.S. franchisors have international operations. A thousand more U.S. franchisors plan to go international over the next 5 years.

In 1989, Bruce J. Walker D.B.A., Department of Marketing, Arizona State University, prepared a study for the International Franchise Association entitled "A Comparison of International vs. Domestic Expansion by U.S. Franchise Systems." Six major conclusions were deduced by the survey:

1. The international operations of U.S. franchise systems are rather small at this time but are likely to grow rapidly.

2. Canada is the key country in the international expansion activities and plans of U.S. franchise systems.

3. There is no single pattern to international expansion by U.S. franchise systems.

4. U.S. franchise systems make only selective modifications in key strategies and methods when they expand into other countries.

5. Maintaining adequate control represents the most significant challenge to international expansion.

6. Franchisors are very satisfied with their international expansion.

It is beyond the scope of this chapter to discuss in great depth the laws of over 160 foreign countries that may impact your client's decision to franchise internationally. This chapter is designed to sensitize you to the principal legal issues that must be addressed when your client intends to franchise in a foreign country. This approach is fairly uniform regardless of the target country.

Two primary sources to refer to for information on international franchising and the laws of target countries that may impact upon your client's international franchising activities are:

1. *International Franchising* by Alex S. Konigsberg Q.C. 1991 Transnational Juris Publications; and

2. *Survey of Foreign Laws and Regulations Affecting International Franchising* (prepared by the Franchise Committee, Section of Antitrust Law, American Bar Association 1989 2d. Edition) which surveys the laws of Australia, Belgium, Brazil, Canada, Denmark, EEC (Antitrust Laws), France,

Germany, Hong Kong, Israel, Italy, Japan, South Korea, Mexico, Netherlands, New Zealand, Philippines, Singapore, South Africa, Spain, Sweden, Switzerland, Taiwan, United Kingdom and the United States.

II. WAYS TO EXPAND INTERNATIONALLY

Over the last 20 years there has developed three basic vehicles in which a U.S. franchisor expands internationally: (i) directly; (ii) joint venture; and (iii) master franchising, with master franchising being the most common method. 88.2% of foreign franchise units were sold directly or through master franchise agreements. (*Franchising in the Economy* 1988-1990 p. 98).

The best format depends on a number of factors, including:

1. Existing management resources of the franchisor;
2. Capital resources of the franchisor;
3. Foreign investment restrictions and/or tax incentives;
4. Currency restrictions;
5. Foreign exchange and foreign trade restrictions;
6. Tax treaties and taxation;
7. Industrial and intellectual property laws;
8. Corporate laws;
9. Import/export controls;
10. Excise taxes and duties; and
11. Political and economic stability issues.

Time and the scope of this chapter prevent delving into all of these issues. Nevertheless, each of these issues must be looked at when expansion is contemplated to determine the best approach. The best vehicle for your client must be determined on a country-by-country basis as well as a transaction-by-transaction basis.

A. Direct Franchising

In direct franchising, the U.S. franchisor directly enters into a development agreement (multiple units) and/or a franchise agreement (single unit) with a foreign franchisee without the use of an intermediary (e.g., master franchisee or subfranchisor). Inquiry must be made to insure that the laws of the target country permit direct franchising and what the U.S. franchisor must do to comply with the target country's laws. Your client may be required to establish a branch office or a foreign subsidiary in the target country.

B. Joint Venture Agreements

The U.S. franchisor enters into a joint venture agreement with a joint venture partner who is usually a national of the target country whereby the parties form a joint venture company, joint venture partnership or trust. The joint venture then opens its own units in the target country or grants franchises.

C. International Master Franchise Agreements

An international master franchise agreement is similar to the sub-franchisor concept used in the United States. The U.S. franchisor grants to the master franchisee an exclusive territory (*e.g.*, country) and the master franchisee is responsible for selling and servicing foreign unit franchises within the exclusive territory. The basic structure of an international master franchise agreement (all subject to negotiation by the parties) is as follows:

1. The master franchisee is granted an exclusive territory (*e.g.*, country) and must develop a prescribed number of franchises pursuant to a schedule of development contained in the international master franchise agreement. The master franchisee may or may not be granted the right to open its own units.

2. The U.S. franchisor gives to the master franchisee rights to the trade name and other proprietary marks, the business format, loan of the manuals, initial training (train-the-trainer) and other assistance.

3. The master franchisee usually pays an up-front master franchise fee to the U.S. franchisor for the international master franchise agreement rights.

4. The master franchisee signs the franchise agreement with the foreign unit franchisee (the U.S. franchisor is not a party). The master franchisee assumes all sales and servicing functions, including training and ongoing support of the foreign unit franchisee.

5. The master franchisee receives all initial franchise fees and royalties from the foreign unit franchisees and remits a portion of each (*e.g.*, 1/3) to the U.S. franchisor.

C. Advantages of International Master Franchise

The reasons why a U.S. franchisor would want an international master franchisee instead of opening company-owned units or direct franchising include:

1. Rapid expansion;

2. Greater resources;

3. Reduced staff;

4. Sharing of risk;

5. Access to other ideas;

6. Local presence and knowledge;

7. Greater incentive for the master franchisee to sell and service franchises;

8. Foreign investment restrictions; and

9. Alleviate various tax and tariff problems.

D. Disadvantages of International Master Franchising

The reasons why a U.S. franchisor may want to franchise directly include:

1. Loss of control;

2. Loss of revenue;

3. Increased risk of vicarious liability;

4. Difficulties in enforcement; and

5. Concessions required by a master franchisee.

E. Key Issues in Structuring an International Master Franchise Agreement

In negotiating and drafting an international master franchise agreement, the following key issues should be addressed:

1. Description of the right to be granted by the U.S. franchisor to the master franchisee, including the proprietary marks, know-how, confidential information, manuals, right to franchise, etc.

2. The master franchise territory;

3. Exclusivity;

4. Initial term and renewal term;

5. Duties of the U.S. franchisor;

6. Master franchise fee, sharing of initial franchise fee and royalties and other fees such as renewal fee and transfer fee (including type and method of payment, risk of currency fluctuations, exchange controls and inflationary safeguards);

7. Withholding of taxes and gross up provisions;

8. Duties of the master franchisee;

9. Schedule of development;

10. Proprietary marks;

11. Confidential manuals and confidential information;

12. Accounting and records;

13. Transfer of interest (assets or stock);

14. Default and termination;

15. Obligations upon termination;

16. Independent contractor and indemnification;

17. Representations and warranties; and

18. Choice of law and venue.

II. FOREIGN LAWS IMPACTING ON FRANCHISING

A. In General

The United States has the most extensive franchise laws in the world with its FTC Franchise Rule and various state disclosure/registration and/or relationship laws. While there is no exact counterpart to the FTC Franchise Rule in other countries (other than the province of Alberta, Canada, see § 11.16 below), other types of laws will directly impact your client's franchising activities. Furthermore, other countries are looking to the U.S. franchise laws as a model for their own franchise legislation. Some countries have already made limited pre-sale disclosure a voluntary measure as part of an attempt at self-regulation such as Canada, Great Britain and Australia, while other countries have made limited pre-sale disclosure mandatory such as France. With each transaction, a review of current laws in the target country and their applicability to the transaction at hand must be made. It is extremely important to retain local counsel in the target country knowledgeable in the target country's laws that may affect the relationship.

B. Specific Laws

Some of the types of laws that may impact on whether, and in what manner, a U.S. franchisor may franchise in a target country may include:

1. Trademark Laws

A United States trademark registration gives the trademark owner certain rights in the United States but not elsewhere. The foreign franchisee will want to know that your client has rights to the trademarks in the target country. The United States trademark should be registered as a foreign mark in the target country. The trademark laws in the target country may be different from those of the United States including actual use versus intent to use, initial term and renewal rights, the need for registered user agreements, sublicensing rights and the right to sue for infringement, to name a few. In addition, the laws may be substantially different, or do not exist at all, for the protection of trade secrets.

2. Forms of Doing Business

Depending on which way your client intends to franchise in the target country, issues of foreign investment restrictions, required investment and the participation of a national of the target country, authorization, qualification and registration requirements as well as tax considerations (see § 11.13 below) arise. Can your client franchise directly or must it establish a branch or subsidiary? Does your client have to register of otherwise qualify to do business in the target country? Are there minimum capital investment requirements or local investment requirements?

3. Tax Aspects

Taxes are a major consideration in structuring an international franchise transaction. Does a tax treaty exist between the United States and the target country? What types of business entities are taxed in the target country and in what manner? Can double taxation be avoided in some fashion? Is there a foreign tax credit given against taxes paid by the U.S. franchisor in the target country? Are franchise fees, royalties and other payments amortizable or deductible by the franchisee? Must a franchisee withhold taxes in connection with payments made to the U.S. franchisor? Are there different tax rates between fees paid by the franchisee for services and other technical assistance and fees for the use of the U.S. franchisor's trademark and other proprietary property? If so, is it possible to "unbundle" and allocate the royalty fees among the various services and rights granted by the U.S. franchisor so as to minimize the amount of taxes withheld or otherwise due? Besides income taxes, are there other types of taxes such a value-added taxes (VAT), excise taxes, import or export duties and tariffs, stamp taxes or other taxes not based on income? It is extremely important to retain tax counsel knowledgeable in international taxation involved at the inception of structuring the transaction to minimize the amount of taxes that must be paid by all parties to the transaction.

4. Antitrust (Competition) Laws

Does the target country have any antitrust or competition laws that may make certain provisions commonly included in a U.S. franchise agreement unenforceable or illegal? These provisions may include territorial or customer restrictions, required purchases from the U.S. franchisor or master franchisee or their affiliates, exclusive dealing arrangements, agreements limiting competition and in-term and post-term covenants not to compete.

5. Other Laws

Other laws that may impact your client's transaction include special laws that regulate the industry in which your client and its franchisees operate, foreign investment tax or other incentives, tax abatement or subsidies, labor laws, real estate laws, and insurance/liability laws.

III. A BRIEF TOUR OF THE WORLD OF FRANCHISING

The following is a brief summary of countries where U.S. franchising activity is most active:

A. Canada

Canada is usually the first point of embarkation for a U.S. franchisor for a variety of reasons including its proximity to the United States, and the similarity of language (sorry Quebec!) and society. Canada has no federal law similar to the FTC Franchise Rule. The common law of Canada and its provinces affect the contractual relationship between the franchisor and the franchisee. However, the Province of Alberta has a registration/disclosure statute called The Franchises Act that is patterned after the California Franchise Investment Act. Many U.S.-Canada master franchise relationships specifically exclude the sale of franchises in Alberta or to residents of Alberta. The Quebec Civil Code requires a franchisor to act in good faith in the performance of contract rights, to use plain language (French) in agreements, and to require franchisor to give access to any document referenced in a franchise agreement. Recently, the Trademark Act was amended to eliminate the requirement of recording a Registered Users Agreement between the U.S. franchisor and a Canadian franchisee.

The North American Free Trade Agreement (NAFTA), when fully implemented, will create an integrated market between Canada, the United States and Mexico, which should further encourage cross-border investment and ease cross-border trade.

The Canadian Franchise Association has adopted a voluntary pre-sale disclosure scheme and a revised code of ethics. The CFA information circular requires disclosure of 12 categories of information:

1. **Corporate name of franchisor and affiliates.** The franchisor and all affiliates that deal with franchisees must be named.

2. **Trademarks.** All trademarks used in the operation of the system must be disclosed, along with their owners and their registration status.

3. **Business experience of the franchisor.** A brief statement must describe the franchisor's experience with the franchised business.

4. **Major shareholders and directors.** The franchisor must identify all of its directors and major shareholders, describe their business experience, and give details of any criminal conviction arising within 7 years.

5. **Franchising experience of franchisor.** A summary of franchising experience must state the date the franchisor stated selling franchises, set out the year-by-year number of franchises, and note any other franchise system previously or currently operated by the franchisor.

6. **Existing franchisees.** Current franchisees, their locations, and the year they joined the system must be disclosed.

7. **Corporate outlets.** Franchisor-owned outlets must be listed by their address and their date of opening.

8. **Required investment by the franchisee.** The franchisee's required investment must be broken down into categories.

9. **Franchise documents.** The significant provisions of the franchise agreement must be briefly summarized.

10. **Opportunity to review document and obtain advice.** The franchisee must be given sufficient time to investigate the franchise, to review the documents, and to obtain professional advice.

11. **Bankruptcy and insolvency.** The franchisor must disclose any bankruptcy or insolvency by the franchisor or a principal during the previous 10 years.

12. **Existing litigation.** The franchisor's ongoing material litigation with current or former franchisees must be listed in reasonable detail.

The revised code of ethics requires franchisors to make full and accurate disclosure of franchise information to prospective franchisees, to include all material matters in franchise agreements, to provide reasonable training and supervision, to exercise fairness in dealing with franchisees, to use alternative dispute resolution mechanisms prior to resorting to court proceedings, and to encourage prospective franchisees to contact existing franchisees and to seek professional advice before signing the franchise agreement. If a member is charged with violating the code, the CFA will investigate and determine whether there was a violation. The penalty for such a violation is revocation of CFA membership.

B. Mexico

Mexico has become a far more receptive target country in recent years for a number of reasons. NAFTA has opened doors and numerous business opportunities for U.S. franchisors. The Mexican market for franchising increased 404% between 1991 and 1993 and is expected to grow at least 20% per year for the next 3 years.

In 1991, Mexico modernized its franchising policies by replacing the "old" Transfer of Technology law, which required the registration of all franchise agreements, with the new Law for the Promotion and Protection of Industrial Property. The new law has completely overhauled the legal and regulatory framework that stifled technological development in Mexico. Generally speaking, the law provides for the protection of patents, trademarks, industrial trade secrets, and other industrial property concepts while it sets forth the legal procedures that intellectual property holders may use against infringers. Under the statute, franchisors are no longer required to register franchise agreements.

Significantly, the new law defines a "franchise" and requires pre-sale disclosure of information to prospective franchise purchasers, the filing of information about the franchisor, and registration of the transmission of trademark rights to the franchisee. The obligation to disclose information to prospective franchisee was originally provided in the Industrial Property Law (Section 142), enacted on June 27, 1991. Although the obligation to disclose has been mandated since June 1991, the statute did not specify the nature of the disclosure and caused franchisor uncertainty. However, on November 23, 1994, regulations under the Industrial Property Law were published, effective December 8, 1994. Section 65 of the Regulations provides a list of 10 items that have to be disclosed by franchisors to prospective franchisees:

1. Franchisor's name, corporate name, domicile and nationality;

2. Franchise description;

3. Franchisor's time in operating the business and, if applicable, the time of master franchisee in operating the business;

4. Copyrights included in the franchise;

5. Amounts and types of payments to be made by franchisee to franchisor;

6. Types of services and technical assistance to be provided by franchisor to franchisee;

7. Definition of geographical area in which the business developing the franchise will operate;

8. Whether the franchisor has the right to grant subfranchises to third parties, and, if applicable, the requirements which must be fulfilled in doing so;

9. Franchisee's obligations regarding confidential information provided by franchisor;

10. In general, franchisee's rights and obligations derived from the execution of the franchise agreement.

It is important to note that the Regulations do not appear to require franchisors to submit a "disclosure document" with the Industrial Property Institute or any other Mexican governmental authority for its approval.

The last paragraph of Article 142 of The Industrial Property Law establishes that the provisions of Chapter VI (relating to trademark licenses) apply to the registration of franchises. Accordingly, upon execution of a franchise agreement, the franchisor must record registered user agreements with The Ministry of Commerce.

Franchise agreements must be registered before the Mexican Institute of the Industrial Property. The application for registration of the franchise must comply with the following requirements:

1. All the copies must be duly signed;

2. Official formats must be used;

3. All documents written in a language other than Spanish must be translated into Spanish;

4. All foreign documents must be legalized;

5. Provide the franchisor's or franchisee's name, corporate domiciles, nationalities and domiciles;

6. State the term of the agreement;

7. Provide whether the agreement reserves to the franchisor the right to initiate any and all legal actions to protect industrial property regulated under the agreement;

8. Provide all other information required by the official formats.

A certified copy or an original copy of the franchise agreement must be attached to the registration application. It is possible to exclude from the attached franchise agreement all provisions making reference to royalties and other payments required by the franchisee as confidential information, and to channels of distribution and forms of commercialization of the goods and services, as well as all the enclosures referring to technical information which are part of the agreement. Any of the parties may file the application for registration.

With respect to all products sold or services to be rendered under a franchise trademark, registration requirements include the following (in addition to that required by the Industrial Property Law, *e.g.*, products or services should be of the same quality as those manufactured or rendered by the owner of the trademark and shall indicate the name of the user):

1. Name and domicile of the owner of the trademark;

2. Franchisee's name and domicile; and

3. The use of the trademark under a license.

C. European Economic Community (Belgium, Denmark, France, Greece, Ireland, Italy, Luxembourg, Netherlands, United Kingdom, and Germany)

The EEC is comprised of a single market of over 360,000,000 people. In general, there are no specific EC laws governing franchising. Franchising and other business agreements are subject to Article 85 of the Treaty of Rome and the competition laws of each member country. On November 30, 1988, the European Economic Commission adopted Commission Regulation 4087/88 known as the "Franchising Block Exemption." It is effective from February 1, 1989 until December 31, 1999. By complying with the terms of the Franchising Block Exemption, franchisors will gain automatic exemption from Article 85 of the Treaty of Rome. The following summarizes what provisions must, can and cannot be incorporated into franchise agreements under the Franchising Block Exemption:

1. Scope of Coverage

The Franchising Block Exemption applies to distribution franchises concerning the sale of goods and service franchises concerning the rendition of services (*i.e.*, business format franchises). It does not apply to industrial franchise agreements concerning the manufacturing of goods, that is, it does not apply to wholesale franchises. Wholesalers may benefit from other block exemptions if they fulfill the necessary conditions (*e.g.*, the "Know-How Regulation" No. 556/89). The Franchising Block Exemption also does not apply to motor vehicles, service stations and beer supply, which are subject to specific block exemption regulations. The Franchising Block Exemption covers single-unit franchise agreements between the franchisor and the franchisee as well as the multi-unit agreements between the franchisor and a master franchisee, such as area development agreements and international master franchise agreements.

2. Definitions

Article 1 contains definitions of the following terms: "franchise," "franchise agreement," "master franchise agreement," "franchisor's goods," "contract premises," "know-how," "secret," "substantial" and "identified." The Franchising Block Exemption provides that there are three elements to a franchise: (i) the use of a common name or a sign and a uniform presentation of contract premises; (ii) the communication by the franchisor to the franchisee of substantial know-how; and (iii) the continuous provision by the franchisor to the franchisee of commercial or technical assistance.

3. Permissible Restrictions

Article 2 allows the following restrictions on competition (which are normally included in many U.S. franchise agreements):

(a) A franchisor can agree not to do any of the following in the exclusive territory:

(i) Not grant another franchise to another franchisee;

(ii) Not compete with the franchisee; and/or

(iii) Not supply competing goods to any third parties.

(b) A master franchisee/area developer may agree not to grant franchises outside of the exclusive territory.

(c) A franchisee may agree to:

(i) Only operate the franchise from a specific location;

(ii) Not solicit customers outside the exclusive territory; and/or

(iii) Not manufacture, sell or use in the course of providing services goods competing with the franchise goods (this does not include spare parts or accessories).

4. Conditionally Permitted Obligations

Article 3(1) allows additional permitted obligations to be imposed upon franchisees insofar as these obligations are necessary to protect the franchisor's industrial or intellectual property rights or to maintain the common identity and reputation of the franchise network. These obligations are:

(a) To require the franchisee to sell or use in the course of providing services, exclusively goods meeting the franchisor's minimum objective quality specifications (this is consistent with most U.S. franchise agreements);

(b) To require the franchisee to purchase goods manufactured by the franchisor or by third parties where quality specifications are not possible due to the nature of the goods (this is consistent with most U.S. franchise agreements);

(c) To allow in-term and post-term (up to one year after termination) non-competition clauses protecting the franchisor and any other franchisee but only within the exclusive territory (this is more restrictive than under most U.S. state laws and franchise agreements);

(d) To prohibit the franchisee from acquiring a financial interest in a competitor which would give the franchisee the power to influence the economic conduct of the franchisor (this is more liberal than most U.S. franchise agreements);

(e) To require the franchisee to sell the goods only to end users, to other franchisees and to resellers within other channels of distribution supplied by the manufacturer or with its consent (this is more liberal than most U.S. franchise agreements);

(f) To require the franchisee to use best efforts to sell the goods or provide the services which are subject to the franchise (this is consistent with most U.S. franchise agreements);

(g) To require the franchisee to offer for sale a minimum range of goods, achieve a minimum turnover, plan its orders in advance, keep minimum stocks and provide customer and warranty services (this is consistent with many U.S. franchise agreements); and

(h) To require the franchisee to pay to the franchisor a specified proportion of its revenue for advertising and engage in local advertising which is subject to the franchisor's prior approval (this is consistent with most U.S. franchise agreements).

5. Unconditional Permitted Obligations

In addition, the following unconditional permitted obligations of the franchisee can be imposed:

(a) The franchisee shall not disclose to third parties the know-how provided by the franchisor, including after the termination of the franchise agreement (this is consistent with most U.S. franchise agreements);

(b) The franchisee shall communicate the franchisor any experience gained in exploiting the franchise and to grant to the franchisor and the other franchisees a non-exclusive license for the know-how resulting from that experience. (This is different from U.S. practice whereby under most franchise agreements the franchisor becomes the sole owner of this information, not merely a non-exclusive licensee);

(c) The franchisee must inform the franchisor of infringements, license, industrial or intellectual property rights and take legal action against infringers or assist the franchisor in any legal actions against infringers (this is consistent with most U.S. franchise agreements);

(d) The franchisee shall only use the know-how licensed under the agreement pursuant to the franchise agreement and not use it after termination of the franchise agreement (this is consistent with most U.S. franchise agreements);

(e) The franchisee shall attend or have its staff attend training courses arranged by the franchisor (this is consistent with most U.S. franchise agreements);

(f) The franchisee shall apply the commercial methods devised by the franchisor, including any subsequent modification thereof, and use the license, industrial and intellectual property rights (this is consistent with most U.S. franchise agreements);

(g) The franchisee shall comply with the franchisor's standard for the equipment and the premises and/or means of transport (this is consistent with most U.S. franchise agreements);

(h) The franchisee shall allow the franchisor to inspect the premises and/or means of transport, including the goods sold and the services provided and the inventory and accounts of the franchisee (this is consistent with most U.S. franchise agreements);

(i) The franchisee shall not relocate the franchised premises without the franchisor's prior consent (this is consistent with most U.S. franchise agreements); and

(j) The franchisee shall not assign the rights or obligations under the franchise agreement without the franchisor's consent (this is consistent with most U.S. franchise agreements).

6. Compulsory Provisions

Under Article 4, the following provisions must be contained in any franchise agreement in order for the Franchising Block Exemption to apply:

(a) The franchisee must be free to obtain its goods from other franchisees or other authorized distributors (this is more liberal than provided in most U.S. franchise agreements).

(b) Where the franchisor obligates the franchisee to honor guarantees, the guarantee obligation shall apply as to any goods supplied by any member of the franchise network or other distributors which give similar guarantees in the Common Market (this is consistent with most U.S. franchise agreements); and

(c) The franchisee must indicate its status as an independent contractor, but this should not interfere with the trademark signage (this is consistent with most U.S. franchise agreements).

7. Prohibited Provisions

Article 5 prohibits the inclusion of any of the following provisions; otherwise, the Franchise Block Exemption is not available:

(a) Agreements between competing manufacturers/suppliers of identical or similar goods or services (this is similar to the prohibitions under U.S. antitrust laws);

(b) Prohibiting the franchisee from obtaining supplies or goods of a quality equivalent to those offered by the franchisor, subject to the franchisor's right to approve suppliers (this is similar to U.S. anti-tying restrictions);

(c) A franchisor refusing to designate as an approved supplier, a supplier proposed by the franchisee if such refusal is for reasons other than protecting the franchisor's industrial or intellectual property rights, or maintaining the common identity and reputation of the franchise network (this is similar to U.S. anti-tying restrictions);

(d) Prohibiting the franchisee from continuing to use the license know-how after termination of the franchise agreement where the know-how has become generally known or easily accessible other than by breach of an obligation by the franchisee (this is fairly consistent with U.S. state trade secret laws);

(e) A prohibition against the franchisee from setting its own prices. The franchisor cannot set either minimum or maximum prices although the franchisor can recommend prices. (This is similar to U.S. antitrust laws);

(f) Prohibiting the franchisee from contesting the validity of the franchisor's industrial or intellectual property rights (this is a common prohibition in U.S. franchise agreements); and

(g) Restricting a franchisee's ability to sell goods or provide services to end users because of their place of residence (this is similar to U.S. antitrust laws).

8. Opposition Procedure

Under Article 6, any agreement that fulfills the conditions of Article 4 can take advantage of the Franchising Block Exemption even thought it contains restrictions on competition which are not covered by Articles 2 and 3 but do not come within Article 5 (*e.g.*, a refurbishment provision) provided the agreements in question are notified to the Commission in accordance with Commission Regulation Number 27 and the Commission does not oppose such exemption within a period of six months from such notification.

9. Withdraw of Exemption

Under Article 8, the Commission can withdraw the benefit of the Franchising Block Exemption if an agreement, although in compliance with the Franchising Block Exemption, nevertheless has certain effects which are incompatible with Article 85(3), and in particular where territorial protection is awarded to the franchisee; and

(a) Access to the relevant market or competition is significantly restricted by the cumulative effect of parallel networks of similar agreements established by competing manufacturers or distributors;

(b) The goods or services do not face, in a substantial part of the Common Market, effective competition from goods or services which are identical or considered by users as equivalent in view of their characteristics, price and intended use;

(c) The parties, or one of them, prevent end-users from obtaining, directly or indirectly, the goods or services because of their place of residence;

(d) Franchisees engage in price fixing; or

(e) The franchisor uses its inspection right, its right to restrict relocation or to consent to the transfer of the franchise agreement for reasons other than protecting its trademarks.

D. Competition Laws of Member Countries

The Section of Antitrust Law of the American Bar Association has published the second edition of the Survey of Foreign Laws and Regulations Affecting International Franchising. The second edition (1990) updates the first edition published in 1982 and includes several more countries. Most of the EEC member countries as well as the antitrust laws of the EEC are included in the survey.

1. Belgium

(a) The Belgium government maintains a very positive attitude towards foreign investment.

(b) The Belgium government is neutral towards franchising.

(c) Bills concerning the regulation of franchise agreements have been introduced in Parliament, but these bills have not resulted in the promulgation of a franchise law.

(d) There is no legislation, current or proposed, that would require foreign franchisors to register with or seek the approval of any ministry or agency prior to selling a franchise.

2. Denmark

(a) The attitude of the Danish government and legislature toward foreign investment has traditionally been benevolent.

(b) The government has a neutral attitude towards franchising as it is a new, developing business concept in Denmark.

(c) There is no legislation or act that is pending particularly focused on franchising.

(d) There is no law requiring the registration of a franchise in Denmark.

3. France

(a) The attitude of French authorities toward foreign investments has been to establish a system of authorizations and declarations for foreign investments in France, such as loans, guarantees, shareholding in French companies, purchase of real estate, etc.

(b) There is no specific attitude of the French government with respect to franchising in general, or the entry of foreign franchising in France.

(c) France has about 700 franchisors with over 33,000 units.

(d) There is a French pre-sale disclosure law called "Loi Doubin" (similar but not as extensive as the FTC Franchise Rule) which requires a disclosure document be given at least 20 days before a franchisee or developer can sign any agreement with the franchisor or the franchisor can take any money. The information includes:

(i) Description of the franchisor's business;

(ii) Description of the franchisor's experience;

(iii) Description of the franchisor's supply network and methods of operation;

(iv) Description of the present state of the market and prospects for its development;

(v) Size of the franchise network; and

(vi) Principal contract terms (term, renewal, termination, transfer, area of exclusivity).

4. Germany

(a) The attitude of the Federal Republic of Germany towards direct foreign investment has been to treat foreign investors on the basis of equality of domestic investors.

(b) The German Franchise Association in Munich is a useful source of information for franchising in Germany. It may now be said that the general attitude is very positive.

(c) No legislation is in existence in Germany that specifically refers or defines franchising.

(d) The unification of Germany has not altered the current situation.

(e) There are approximately 420 franchisors operating 18,000 units with total sales of U.S.$12.2 billion.

5. Italy

(a) While there is no legislation which would particularly favor foreign over domestic investment in Italy, a persistently high level of chronic unemployment makes Italy very favorably inclined towards foreign investment.

(b) There is no particular attitude of the government with respect to franchising, domestic or foreign.

(c) There is no franchise legislation being introduced in the Italian Parliament and none is expected in the foreseeable future.

(d) A franchise operated within Italy must take into account the provisions of the Italian Civil Code dealing with commercial agreements and also the Industrial and Intellectual Property Laws and the Antitrust Law of 1990.

(e) The Italian Franchise Association is proposing a self-regulation code.

6. The Netherlands

(a) The attitude of the Netherlands government is traditionally favorable towards foreign investment.

(b) The attitude of the Netherlands government is favorable towards franchising in general. Foreign and national franchising are equally favored. American experience in franchising is welcome.

(c) The Netherlands have not adopted any legislation specifically concerning franchising. Official policy is not directed specifically at franchising, but is generally favorable.

(d) No legislation concerning franchising is pending.

7. Spain

(a) The Spanish government favors the increase of foreign investment in the domestic economy.

(b) Although the concept of franchising is comparatively new in Spain, official agencies have a positive attitude towards it.

(c) Franchising is not regulated in Spanish legislation. There is no legislation specifically referring to franchising. However, there must be compliance with the "Brand Name Law" and Spain's competition law.

(d) Spain has approximately 117 franchisor operating about 14,500 units.

8. United Kingdom

(a) The government encourages foreign investment, particularly in manufacturing and where it involves activities with potential for significant employment generation. The government recognizes that franchising offers considerable potential for business formation and job and wealth creation in the U.K.

(b) The only U.K. legislation that particularly focuses on franchising is the Fair Trading Act of 1973. Part IX is devoted to pyramid selling schemes and could affect the structure of a franchise where it is intended to submit sub-franchise agreements.

(c) The Restrictive Trade Practices Act of 1976 may apply if an exclusive territory is granted to a franchisee, otherwise, franchise agreements do not have to be registered with the Office of Fair Trading.

(d) The U.K. government announced in late 1988 that a review is being conducted of its legislation, and it is possible that some changes may be introduced.

(e) The U.K. has over 400 franchisors with about 20,000 units.

E. Japan

Japan has a bustling economy with a legal structure not as complex or all-encompassing as that of the United States. There are far fewer attorneys and litigation is a "loss of face" for all litigants. There is a social aspect to doing business there. Negotiations are extensive and take a long time as the parties attempt to get to know each other as much as possible before entering into a business relationship. Japanese customs, not just their laws, have to be taken into account in doing business in Japan.

Although foreign investment is not substantially restricted and a U.S. franchisor can open a branch or subsidiary, most U.S. franchisors enter into a master franchise agreement with a Japanese company that acts as the subfranchisor of the U.S. franchisor's concept in Japan and subfranchises to Japanese franchisees. The master franchise agreement is considered a "technical assistance agreement." A technical assistance agreement between a U.S. company and a resident of Japan is subject to the Foreign Exchange and Foreign Trade Control Law (the "FECL"). The FECL requires the filing of the master franchise agreement with the Japanese Fair Trade Commission, which reviews the agreement to ensure that its provisions do not violate various laws regarding monopolization, unreasonable restraints of trade and unfair business practices. The filing must be made within 30 days after execution of the agreement.

In light of the striking difference between medium- and small-scale enterprises and large-scale enterprises, particularly durability and strength, Japan enacted the Law Concerning the Development of Middle- and Small-Scale Retailers of 1973 (the "Retailers Law") to protect and assist these weaker businesses. A medium- or small-scale enterprise is any business that has capital (*i.e.* net worth) of not more than ten million yen and employing not more than 50 persons. The Retailers Law applies to businesses selling products to ultimate consumers, not to service businesses. At present there are approximately 1,600,000 businesses meeting this definition.

Some of the benefits afforded to medium- and small-scale enterprises under the Retailers Law include government loans at low interest rates for improvements such as beautification of entranceways and store premises to make the retail establishment more attractive to customers. A Japanese franchisee may be subject to the Retailers' Law and qualify for its benefits.

The Retainers Law defines "Chain Business" and "Specific Chain Business" which definitions may impact upon U.S. franchising activities in Japan. A "Chain Business" is a business: (a) involving medium- and small-scale enterprises; (b) based on a standard form agreement; and (c) engaged in the continuous sale of goods and management assistance. "Specific Chain Business" is a Chain Business where the standard form of agreement provides for: (d) the granting of trademarks, trade names or other marks for the business operation; and (e) the payment by the applicant of a certain amount of money, such as a down payment or deposit.

Any person or corporation operating a Specific Chain Business as a franchisor must give an applicant for such business (a prospective franchisee) the following information in writing:

1. Initial payment of money to be deposited or transferred by the applicant;

2. Condition or method of sales of goods;

3. Management assistance to be rendered;

4. Trademarks or any other marks to be used by the applicant;

5. Term, renewal, termination, or cancellation of the agreement;

6. Name, address and representatives of the person or corporation operating the Specific Chain Business;

7. Date of commencement of the Specific Chain Business;

8. Money to be paid periodically by the applicant; and

9. Obligation of the applicant with regard to structure, design, or layout of the store.

This disclosure document does not have to be filed with the Japanese government. There are no formal sanctions for non-compliance except public notice of non-compliance. The threat of public notice of non-compliance is usually a sufficient "stick" to assure compliance as such disclosure would be considered a loss of face. However, as discussed below, the Japanese Franchise Association requires its members to comply as a condition of membership.

The Japanese Franchise Association ("JFA") has been established in Japan. The JFA is composed of approximately 178 franchisors out of approximately 570 franchisors in Japan. These 178 franchisors represent a majority of the franchise units in Japan, as the larger franchise companies are members of the JFA. Based on information reported to the Japanese Ministry of International Trade and Industry, the number of franchisors and the units represented are as follows:

Year	Franchisors	Units
1979	335	N/A
1980	365	46,371
1982	424	N/A
1983	438	N/A
1984	469	N/A
1985	462	N/A
1986	492	N/A
1987	496	N/A
1989	491	68,301
1990	527	71,967
1991	620	123,365
1992	688	130,144

As mentioned above, Japan's requirement that a disclosure document be given by a franchisor to a prospective franchisee is a voluntary requirement, not a mandatory requirement. However, the JFA helps to comply with the requirements by requiring, as a condition to membership, that its members make the disclosures. Membership in the JFA is considered beneficial because membership connotes that others can trust the company. In order to become a member of the JFA, a franchisor must comply with the following requirements:

1. The franchisor must be considered a person who will not violate public order and possesses good morals; and

2. The franchisor must have not less than one year of actual experience in the management of the business being franchised.

There are no restrictions on repatriating profits, sales or liquidation proceeds from Japan to the United States. However, franchise fees and royalties are subject to a 20% withholding tax.

While few legal restrictions on foreign investments and repatriating profits exist, as demonstrated by the President's recent trip to Japan, trade barriers are the major impediment to doing business in Japan. Certain segments, like the food service industry, have little problem with this area, while other segments, like automotive and computers, have major obstacles. A lessening of these trade barriers such as impact duties and quotas are needed to make Japan more accessible for U.S. franchisors.

F. South Korea

Korea is trying to break away from the penumbra of its neighbor, Japan. Hosting of the 1988 Summer Olympics helped. Korea remains protectionist but is attempting primarily to foster its manufacturing segment. It is in the midst of an austerity program. The threat from North Korea remains a concern to South Koreans as Seoul is only 25 miles from the DMZ.

As in Japan, the most common way a U.S. franchisor enters Korea is through a master franchise agreement with a Korean company that acts as the franchisor of the U.S. franchisor's concept in Korea and subfranchises to Korean franchisees. The master franchise agreement is considered a "technology inducement agreement." The Korean Foreign Capital Inducement Law ("FCIL") requires government approval of all technology inducement agreements. The agreement is approved by a relevant Ministry depending on the nature of the goods or services involved. For instance, food service franchisors are subject to the Ministry of Health and Social Services and consumer goods franchisors are subject to the Ministry of Trade and Industry. The agreement is reviewed to determine whether any of its provisions violate Korea's Fair Trade Act. Review must take place within 20 days or the agreement is deemed approved. It is the Korean company which must submit the application. The appropriate Ministry may require changes to the agreement as a condition to approval and enforcement. In the last few years there has been a liberalization and greater flexibility by the government in allowing provisions customarily found in franchise agreements to remain in the agreement (*e.g.*, return of technology after expiration, sales area restrictions, development schedule) which were previously found objectionable.

Under the FCIL, the Korean government has a Negative List of Industries which lists all activities for which foreign investment is not permitted. Any activity not on the Negative List is permitted. The Negative List is reviewed annually by the Ministry of Finance for deletion of certain market segments to encourage foreign investment in Korea as its economy matures. Many service-type businesses remain on the Negative List as manufacturing is being encouraged. In most cases, there is no restriction on the amount or percentage of investment by U.S. franchisors provided the business is not on the Negative List. However, certain industries and small- and medium-sized enterprises have a 50% maximum foreign equity investment limitation.

If the foreign investment is permitted, the FCIL guarantees the remittance of profits from a foreign-invested Korean company. Initial franchise fees, royalties and other payments can be repatriated. There is a 15% withholding income tax on franchise fees and royalty payments. In addition, royalty payments made by franchisees to foreign franchisors are subject to a value-added tax ("VAT") at the rate of 10% of the gross royalty amount. While previously there were restrictions on the amount of a royalty that could be charged and how it was computed, today there are no restrictions and royalties can be based on gross sales.

G. Hong Kong

Hong Kong continues to exuberate the epitome of capitalism, with a mixture of East and West. Its active port and skyscrapers are the beacons of international commerce, but the shadow of 1997 is beginning to loom.

The most important question on everyone's mind is what is going to happen in 1997. On July 1, 1997 the New Territories (comprising 92% of all land area of Hong Kong) will revert to the Peoples Republic of China. Based on a Joint Declaration between the United Kingdom and China, Hong Kong will become a Special Administrative Region and capitalism is supposed to continue for another 50 years. However, the incident at Tiananmen Square has left people insecure. Many are hedging their bets by formulating exit strategies. Certainly Hong Kong (a city of 6 □ million resid
to be a vibrant and significant economic area regardless of whose sovereignty it is under.

The Hong Kong government actively encourages foreign investment. It has opened five overseas offices, including two in the United States (New York City and San Francisco), to assist overseas investors in investing in Hong Kong. There are no restrictions on foreign investment. There are no restrictions on repatriating profits to the U.S. Hong Kong deems that 10% of the gross royalties paid to a U.S. franchisor are assessable profits subject to the profits tax. The standard corporate income tax rate is 10%. Therefore, the effective corporate profits tax rate for royalties paid to a U.S. franchisor is 1.7%.

Hong Kong is a businessperson's idea of Nirvana. There are no laws affecting franchising. It is purely a matter of contract. There are no franchise registration or disclosure laws. There are no special industry laws. As mentioned above, there are no foreign investment or currency restrictions. There is no requirement of local participation in ownership or management. There are no antitrust laws or regulations, and even restrictive covenants or covenants not to compete are enforceable if they are reasonable.

The Hong Kong Intellectual Property Office handles the registration of patents and trademarks. Service mark registrations commenced in March 1992. Their procedures are similar to that found in the United Kingdom. A franchisee is advised to register as a registered user of the franchisor's trademarks. Trade secrets are protected under the law of confidence imposing a duty upon the disclosee not to use the confidential information for his or her own personal benefit or to disclose it to a third party without the consent of the owner.

H. Caribbean Basin

For franchisors based in Florida, the Caribbean Basin offers the closest point of embarkation for franchising internationally. It must be remembered that the FTC Franchise Rule applies to Puerto Rico and the U.S. Virgin Islands thereby requiring pre-sale disclosure. As to other countries within the Caribbean Basin, you must refer to that country's laws as well as possible the laws of a European country such as the U.K., France of the Netherlands. Most of the island-countries have no specific laws affecting franchising.

I. Brazil

According to the Brazilian Franchise Association, Brazil has approximately 20,000 franchised outlets totaling U.S.$48.1 billion in sales or 10% of Brazil's gross national product. The franchise agreement, including a Portuguese translation thereof, must be filed with the Brazilian Institute of Industrial Property (INPI) which is the government agency in charge of examining and approving franchise agreements entered into with Brazilian companies. INPI's examination of the documents takes from 1 to 3 months, and such examination will be made in accordance with the rules established in INPI Normative Act 115/93. According to the Act, INPI will approve franchise agreements providing for a temporary granting of rights that jointly entail use of trademarks and rendering of technical assistance, or containing any other kind of technology transfer required for attainment of the proposed objectives.

In order to send payments due to the U.S. franchisor abroad, the franchise agreement must also be registered at the Central Bank of Brazil. This registration is only given after the approval of the agreement by the INPI. Thereupon, the franchisee can make payments to the U.S. franchisor in U.S. dollars.

The Brazilian Franchise Association is proposing legislation to more certainly define franchising and to impose an obligation to disclose a variety of information to potential franchisee at least 30 days before the execution of the franchise agreement. The information that would have to be disclosed to potential franchisees would include details of the franchisor's structure and finances, litigation history, details of the business and the franchisee's total investment, a list of all existing franchisees and details of the intellectual property rights involved.

It would not necessary to register the disclosure documents. However, failure to comply with the disclosure requirements would allow the franchisee to revoke the agreement *ab initio*, or in other words to treat the agreement as if it had never existed and claim back all the money it has spent plus damages. The franchisee must exercise this right within 2 years of the franchisee receiving the disclosure documents. Fortunately, international agreements are proposed to be not subject to this disclosure requirement.

J. Australia

IN 1993, Australia adopted a form of voluntary self-regulation of franchising with the Australian Franchising Code of Practice. The Code requires pre-sale franchise disclosure and registration, imposes a 7-day "cooling off" period, provides for mediation of disputes, and relies on private sector incentives for compliance. It established the Franchising Code Administration Council to administer its terms.

The Code created a registry of franchisors, advisors, and service providers that agree to comply with its provisions. A franchisor's non-compliance with the Code can result in revocation of its registration. The incentive to register and maintain registration is intended to come from the private sector. For instance, financial institutions registered as service providers agree to offer customized franchisee financing and service packages only to franchisors that have current registration numbers.

Keith J. Kanouse, Esq.