Managing the Proliferation of Global Franchise Regulation

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I. Evolution of the Franchise Regulatory Landscape

I began practicing franchise law more than thirty-five years ago. Franchise regulation was then in its infancy. California had enacted its Franchise Investment Law1 in 1970, adopting a regulatory regime similar to securities law; that is, registration of the franchise offering with the state and required disclosure to the prospective purchaser. The U.S. Federal Trade Commission (FTC) soon followed with federal regulation, promulgating the original FTC Franchise Rule2 (Original FTC Franchise Rule) in December 1978, with an effective date of October 21, 1979. Applicable in all U.S. states and territories, the Original FTC Franchise Rule mandated pre-sale disclosure, but did not require registration of the franchise offering. In addition to California, a few other states (Registration States)3 adopted franchise sales laws resembling the California Franchise Investment Law model and requiring registration of the franchise offering with the state, as well as disclosure to the prospective franchisee. A number of U.S. states (Relationship States)4 also enacted laws, commonly referred to as “relationship laws,” regulating certain aspects of the post-sale relationship between the franchisor and the franchisee.

2. 16 C.F.R. § 436. The Original FTC Franchise Rule was amended in January 2007.
3. The Registration States include California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin. Oregon also has a franchise law that mandates disclosure. The relevant statutes and regulations are collected in the Business Franchise Guide (CCH).
But throughout the 1970s and 1980s, the franchise regulatory landscape outside the United States was decidedly less robust than the regulatory picture inside the United States. The Canadian province of Alberta adopted a franchise disclosure law in 1971, and the Japan Fair Trade Commission issued certain franchise guidelines in 1983, but it was not until 1989 that another non-U.S. jurisdiction—France—sought to regulate franchising under the Loi Doubin, using a disclosure model for the regulation.

This pattern of domestic franchise regulation, and the relative absence of international franchise regulation, helped shape franchise sales and expansion practices in interesting ways. At the time, the U.S. franchise regulatory regime was perceived as making the franchise sales process costly and unwieldy, and not without reason. In adopting the Original FTC Franchise Rule, the FTC had determined that federal law would not fully preempt state franchise laws:

> The FTC does not intend to preempt the franchise practice laws of any state or local government, except to the extent of any inconsistency with this Rule. A law is not inconsistent with this Rule if it affords prospective franchisees equal or greater protection, such as registration of disclosure documents or more extensive disclosures.8

This approach to regulation meant franchisors had to comply with both federal and state franchise sales laws, and those laws were by no means uniform. Among other consequences, the absence of full federal preemption under the Original FTC Franchise Rule and the divergence in regulations among the Registration States required the creation of multiple different forms of disclosure documents—one for use in the states regulated only under the Original FTC Franchise Rule (Non-Registration States) and separate disclosure documents for use in each of the Registration States.

Aside from the costs of complying with different federal and state regulations and the burdensome process for providing disclosure, the lack of alignment in the regulation of franchise sales created inherent risk. If the laws of multiple states were potentially applicable to a single franchise sale—as, for example, when the franchise prospect resided in one state but planned to open the franchised unit in a second state with communications about the sale taking place in a third state—U.S. franchise law practitioners were challenged to answer such questions as “which disclosure document should

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5. Franchises Act, R.S.A. 1971, c. F-38 (Can.).
7. Loi 89-1008 du 31 décembre 1989 relative au développement des entreprises commerciales et artisanales et à l’amélioration de leur environnement économique, juridique et social [Law 89-1008 of December 31, 1989, on the development of commercial and artisanal enterprises and the improvement of their economic, legal and social environment], Journal Officiel de la République Française [J.O] [Official Gazette Of France], Jan. 1, 1990 (Fr.).
I use?” Franchisors were legitimately concerned that if they provided the wrong disclosure document, the sale might be tainted and the franchisee would have a rescission remedy that could be exercised years later, creating significant risk for the franchisor.

In contrast, the lack of widespread franchise regulation outside the United States was viewed by many as an opportunity. Domestic brands were an attractive business proposition in many foreign jurisdictions, and local operators were eager to partner with U.S. franchisors to take their brands “international.” The fundamental value proposition of the franchise distribution model applied equally outside the United States as it did domestically. In both cases, franchising allowed a franchisee to benefit from the experience of the franchisor and enabled the franchisor to expand the brand rapidly using the resources of the third-party franchisee, without investing the capital and committing the human resources necessary to establish company-owned units. International franchise expansion also offered a franchisor the additional benefits, among others, of being able to:

- utilize local management personnel and thus overcome problems of language and culture;
- overcome problems of detailed supervision often otherwise insuperable because of distance; [and]
- leave compliance with local laws to those familiar with such laws. . . .

During this period, the dearth of franchise sales regulation in jurisdictions outside the United States served to minimize the legal risks of international franchise expansion and allowed U.S. franchisors to shift some of their expansion costs to the local operator by charging significant up-front territory fees. Indeed, at the time there was a perception that international expansion might be necessary to proactively protect the brand by preventing non-U.S. operators from “pirating” popular U.S. brands for development in their home countries.

In the decades following the 1980s, regulatory patterns have shifted. In the United States, franchise disclosure regulation has become more streamlined and better understood. In April 1993, the North American Securities Administrators Association (NASAA) adopted Guidelines for Preparation of the Uniform Franchise Offering Circular and Related Documents (UFOC Guidelines). Disclosure documents prepared in compliance with the UFOC Guidelines were accepted by all of the Registration States, and, in December 1993, the FTC approved the UFOC Guidelines as an alternative to the disclosure format required by the Original FTC Franchise Rule. The FTC’s amendment of the Original FTC Franchise Rule in 2007 (FTC Franchise Rule or Rule) further aligned federal and state disclosure requirements by

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incorporating into the Rule, and adapting, many of the disclosure requirements included in the UFOC Guidelines. Following a one-year grace period subsequent to the July 1, 2007, effective date of the amended Rule, all franchisors selling franchises in the United States were required to conform to the Rule’s disclosure requirements and could no longer prepare disclosure documents under the Original FTC Franchise Rule or the UFOC Guidelines.11 State practice was conformed when, in June 2008, NASAA published the 2008 Franchise Registration and Disclosure Guidelines,12 adopting the disclosure format of the amended Rule and, among other things, adding a state cover page and updating state registration application forms.

Over the years, efficiencies have also developed in the state registration process. Certain Registration States now permit or require that filings be made electronically, thereby expediting the process.13 Four of the Registration States require notice filings only.14 And franchisors that satisfy certain experience and net worth requirements may claim a registration exemption in a number of the Registration States.15

In addition to aligning federal and state disclosure requirements and streamlining registration processes, federal and state regulators have provided important guidance regarding franchise disclosure and registration requirements. In January 2007, the FTC released the Statement of Basis and Purpose in connection with the amendment to the Original FTC Franchise Rule16 and, in May 2008, issued a Compliance Guide to replace the Interpretive Guides to the Original FTC Franchise Rule.17 The staff of the FTC has also addressed Frequently Asked Questions (FAQs) raised in connection with the FTC Franchise Rule.18

NASAA’s Franchise and Business Opportunity Project Group has provided additional significant disclosure guidance as well, including an April 2009 Commentary on the 2008 Franchise Registration and Disclosure

15. See, e.g., CAL. CORP. CODE § 31101(a)–(b); ILL. ADMIN. CODE tit. 14, § 200.202(e); Md. CODE REGS. 02.02.08.10D (l)(a)–(b); N.Y. GEN. BUS. LAW § 684(2)–(3); N.D. CENT. CODE § 51-19-04(l)(a)–(b); 19 R.I. GEN. LAWS § 19-28.1-6(l); WASH. REV. CODE § 19.100.030(4)(b)(i)(A)–(B).
Guidelines, a Multi-Unit Commentary adopted in September 2014 to provide guidance for disclosing multi-unit franchising arrangements (including area development, subfranchise, and area representation arrangements), and a Commentary on Financial Performance Representations adopted in May 2017 to answer questions raised by both regulators and practitioners regarding the disclosure of financial performance representations.

Some differences remain. Importantly, the amended FTC Franchise Rule adopted in 2007 includes three new exemptions from the general requirement under federal law to provide pre-sale disclosure (Sophisticated Investor Exemptions). These exemptions were added to the Rule based on the recognition that franchising today often involves heavily-negotiated, multi-million dollar deals between franchisors and highly sophisticated individuals and corporate franchisees with highly competent counsel. In the course of such deals, prospective franchisees often demand and receive material information from the franchisor that equals or exceeds the disclosures required by the Rule.

Unfortunately, the Registration States have not adopted the Rule’s Sophisticated Investor Exemptions, although some Registration State franchise laws do include exemptions from registration and disclosure premised on the sophistication and bargaining power of the franchisee prospect. In addition, some state franchise laws require a different disclosure period than the fourteen-calendar-day disclosure period required by the FTC Franchise Rule and most state franchise laws.

But significant progress has occurred towards minimizing the differences between federal and state disclosure requirements, and the general alignment of those requirements allows franchisors offering and selling franchises in the United States to make the disclosures required by federal and state franchise laws in one disclosure document with remaining state differences addressed in state-specific addenda. The use of a single disclosure document helps to reduce costs, simplify the disclosure process, and lower the risk of providing the wrong disclosure document. Where Registration State filings are required, clearly defined processes contribute to efficiencies. The additional guidance provided by the FTC and NASAA serves to further establish a common baseline for the franchise regulatory practice in the United States.


States. In short, franchise sales regulation in the United States has matured, and with that maturity has come a measure of stability and predictability that provides the basis for a rational and efficient domestic franchise sales and disclosure process.

During this same period, franchise regulation outside of the United States has proliferated. Since the early 1990s, numerous foreign jurisdictions have enacted laws regulating franchising. Although many of these laws include disclosure, registration, and/or relationship provisions, they are by no means uniform or susceptible to easy categorization. And this regulatory activity shows no signs of abating. Among other recent developments, in 2019, the Kingdom of Saudi Arabia passed a franchise statute, and Egypt and the Netherlands are each considering comments to proposed new franchise laws. Even jurisdictions that have regulated franchising for years continue to reexamine and revise their approaches to that regulation. For example, in September 2019, Indonesia revised its existing franchise law; in December 2019, Brazil adopted a new franchise law to replace franchise legislation that had been in effect in that country since the early 1990s; and, as of this writing, an extensive reexamination of Australia’s franchise law is currently ongoing with changes likely to follow.

For businesses that want to capitalize on the commercial benefits of expanding their brands into other countries using a franchise model, the enactment of numerous and diverse franchise regulations across multiple non-U.S. jurisdictions raises some of the same issues that were presented by early domestic franchise regulation: high costs of compliance and potential increased risk. Franchisors must carefully consider how best to manage those costs and risks when implementing an international franchise expansion program.


26. Government Regulation No. 71/2019 (Indon.) (issued by the Minister of Trade (MOT Regulation 71/2019), revoking a number of regulations that had been enacted between 2012 and 2014).


28. Following reports of abuses in the Australian franchise sector, a Parliamentary Committee conducted an inquiry resulting in a report released in March 2019 setting out seventy-one recommendations for change (Parliamentary Joint Committee on Corporations and Financial Services’ Fairness in Franchising Report or Report). Following the release of the Report, the Government appointed an inter-agency task force to examine the recommendations.
II. International Franchise Regulation: An Exercise in Complexity

A. Variations in the Law

The majority of non-U.S. jurisdictions that regulate franchising require the disclosure of specific information to a prospective franchisee within a specified period of time prior to the occurrence of one or more designated triggering events. In all jurisdictions that require disclosure, execution of a franchise agreement will trigger the requirement to provide disclosure within a designated period of time before the agreement is signed. In some jurisdictions, however, the disclosure requirement may be accelerated, triggered by events that take place earlier in the franchise sales process than execution of the franchise agreement. For example, execution of “an agreement to enter into a franchise agreement” triggers a requirement to provide disclosure in Australia, as does the execution of any “pre-contract” or preliminary franchise agreement, in Brazil. Payment of a fee by the prospective franchisee to the franchisor or its affiliate may also trigger the obligation to provide earlier disclosure.

The time periods specified for making disclosure vary widely among the international disclosure jurisdictions. While many jurisdictions require disclosure at least ten or fourteen days before the event that triggers the requirement to disclose, these time periods are by no means uniform. Mexico’s franchise law imposes perhaps the longest disclosure period of any jurisdiction, requiring that franchisors make disclosure thirty business days before the franchise agreement is executed. The laws of other disclosure jurisdictions lack specificity. For example, Argentina requires disclosure “prior to” the execution of the franchise agreement.

Adding to the complexity, there is no uniform format for disclosure across the international disclosure jurisdictions. In the United States, the required franchise disclosure document (Franchise Disclosure Document or FDD) is in a standard format that can be used, and includes information that is

32. Id.; see also, e.g., the franchise legislation in the Canadian provinces of Alberta, British Columbia, Manitoba, New Brunswick, Ontario, and Prince Edward Island; Trade Practices (Industry Code—Franchising) Regulations 2014 (Cth) sch 1 pt 2 div 2 para 9(1)(e) (Austrl.) (earlier disclosure is required if the prospective franchisee makes a non-refundable payment to the franchisor or its associate in connection with the proposed franchise agreement).
33. Abell, supra note 29.
34. Ley de la Propiedad Industrial [LPI] art. 142, as amended, Diario Oficial de la Federación [DOF], 27-6-1991 (Mex.); Reglamento de la Ley de la Propiedad Industrial [RLPI] art. 65, as amended, Diario Oficial de la Federación [DOF], 23-11-1994 (Mex.).
required to be disclosed, in all fifty states and U.S. territories, with state law differences addressed in state-specific addenda to the FDD.\(^{36}\) No comparable practice exists internationally. Some Canadian franchise law practitioners have developed a consolidated form of disclosure document (Canadian FDD) to satisfy the requirements of, and that can be used to provide mandatory pre-sale disclosure in, each of the Canadian provinces that regulate franchise sales (Canadian Disclosure Provinces),\(^{37}\) but just as the FDD is specific to disclosure in the United States and its territories, the Canadian FDD is specific to the Canadian Disclosure Provinces.

Some U.S. franchisors have developed a form of international disclosure document (IDD) to provide information deemed to be material to franchise prospects in non-U.S. jurisdictions. These IDDs are often based on the franchisor’s form of U.S. Franchise Disclosure Document. However, IDDs have limited utility. They should not be used in international disclosure jurisdictions that require the use of a jurisdiction-specific disclosure format.\(^{38}\) Even if a specific disclosure format is not legally mandated, the use of a single document to address the disclosure requirements of multiple jurisdictions poses other risks. First is the risk of over-disclosure; that is, disclosing more information—or different information—than what is required by the law of a particular jurisdiction. Over-disclosure can increase the risk of misrepresentation claims. In addition, it is virtually impossible to “check the box” for several countries’ disclosure laws in a single document, and any attempt to use a single disclosure document covering multiple disclosure jurisdictions would require extensive customization, potentially resulting in a higher cost of maintaining such a document than the cost to create a tailored document as and when transactions arise. The potential value of an IDD, therefore, appears limited to jurisdictions that do not otherwise have a legally mandated requirement to provide disclosure. Where the local law includes a disclosure mandate, the format for that disclosure and the information that is disclosed must conform to the local law.

In addition to the variations in disclosure formats, the type of information required to be disclosed by law varies from jurisdiction to jurisdiction. U.S. franchisors offering franchises in a non-U.S. jurisdiction may very well be required to disclose information in addition to, and different from, the information included in their U.S. Franchise Disclosure Documents.

For example, under the French franchise disclosure law—the Loi Doubin\(^{39}\)—franchisors are required to make certain pre-sale disclosures to

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\(^{36}\) As of July 1, 2008, franchisors were required to “prepare and distribute disclosure documents that, at a minimum, comply with the disclosure format” of the amended FTC Franchise Rule. However, “states may impose additional requirements under state law consistent with the . . . FTC Franchise Rule,” N. Am. Sec. Adm’rs Assoc., 2008 FRANCHISE REGISTRATION AND DISCLOSURE GUIDELINES, https://www.nasaa.org/wp-content/uploads/2011/08/6-2008UFOC.pdf.

\(^{37}\) These are the provinces of Alberta, British Columbia, Manitoba, New Brunswick, Ontario, and Prince Edward Island.

\(^{38}\) For example, Korea, Indonesia, Malaysia, Vietnam, and Australia.

\(^{39}\) Code de commerce [C. com] [Commercial Code] art. L. 330-3 (Fr.).
potential franchisees at least twenty days before the franchise agreement is executed. In addition to information about the franchisor, the trademarks to be licensed, open and terminated outlets, and the general terms of the franchise relationship, the disclosure document must include “a presentation of the general and local market status for the relevant products or services and the development prospects of such market” (Market Study). A Market Study may include information pertaining to the accessibility of the proposed site, demographics, market potential, information about the competition, and other relevant information. A franchise agreement may be declared null if the franchisor’s Market Study is found to be incomplete or fails to contain information on the local market conditions. Franchisors may therefore find it prudent to engage a company that specializes in preparing Loi Doublin studies to prepare the Market Study.

Even when the information that must be disclosed in another jurisdiction appears to be similar to the information that is disclosed in the United States—or across other international disclosure jurisdictions—the requirements may not be identical, and the standard of review may vary. As a result, U.S. franchisors may be required to modify or supplement the information they disclose in the United States for use internationally. The variation in financial statement disclosure requirements offers one example.

In the United States, the FTC Franchise Rule requires franchisors to disclose audited financial statements of the franchisor that satisfy the requirements of § 436.5(u)(1)(i) and (ii) of the Rule. However, the Rule also permits franchisors to satisfy the financial statement disclosure requirements by using the financial statements of an affiliate, provided that the affiliate’s financial statements satisfy the requirements of § 436.5(u)(1)(i)–(ii) and the affiliate absolutely and unconditionally guarantees the franchisor’s obligations under the franchise agreement. As a result, a U.S. franchisor may not separately audit its financial statements, relying instead on the audited financial statements (and guarantee) of its parent company or other affiliate.

U.S. franchisors expanding abroad may be unpleasantly surprised to find that other jurisdictions with financial statement disclosure requirements may not allow the use of parent or affiliate financial statements to satisfy the requirement, even with a guarantee. Absent an exemption, each of the Canadian Disclosure Provinces require the disclosure document to include financial statements for the most recently completed year of the franchisor’s operations, prepared in accordance with the specific provincial requirements.

40. Id. art. R. 330-1 4, al. 2.
41. 16 C.F.R. § 436.5(u)(1)(iii).
42. See, e.g., Arthur Wishart Act, S.O, 2000, c 3, s 5(4)(b) (Can.); General, O. Reg. 581/00 (Can.).
43. At various points throughout this article, I have referred to advice received from local counsel in certain jurisdictions. That advice was specific to the matter for which counsel was engaged and is included here for illustrative purposes only.
Disclosure Provinces allows the substitution of parent or affiliate financial statements for the financial statements of the franchisor, even if the parent’s or affiliate’s financial statements are consolidated and include the franchisor’s financial information and the parent or other affiliate provides a guarantee. Under Indonesia’s franchise law, the prospectus submitted for registration must include two years of the franchisor’s audited financial statements.  

Local counsel have advised that the Indonesian Ministry of Trade will not accept the audited financial statements of an affiliate as a substitute for those of the franchisor entity. Audited financial statements of the franchisor also must be submitted as part of the registration process under South Korea’s Fair Transaction in Franchise Business Act (Korea Franchise Act or KFA). In contrast to Indonesia, local counsel in South Korea have advised that the Korean Fair Trade Commission (KFTC) has accepted audited statements of a franchisor’s parent company, but only rarely and for a compelling reason. However, they also have advised that the KFTC may accept unaudited financial statements of the franchisor if audited statements are not available.

Apart from the additional and differing international disclosure requirements U.S. franchisors confront in expanding internationally, some non-U.S. jurisdictions require pre-sale registration of the franchisor, the disclosure document, and/or the franchise agreement. In Vietnam, foreign franchisors have historically been required to register with the Ministry of Industry and Trade prior to selling franchises. Before selling a franchise in Malaysia, a foreign franchisor must obtain approval from the Franchise Development Division of the Ministry of Domestic Trade and Consumer Affairs, headed by the Registrar of Franchises. Indonesia requires pre-sale registration of the franchisor and of the disclosure document. Other jurisdiction-specific requirements may have to be satisfied prior to closing a franchise sale. In the Philippines, to be valid, the franchise agreement must be pre-cleared under the Technology Transfer Law.  

44. Government Regulation No. 53/M-DAG/PER/8/2012 (Indon.) (issued by the Minister of Trade on Aug. 24, 2012).


46. Government’s Decree No. 35/2006/ND-CP detailing the regulations of the Commercial Law on Franchising (amended and supplemented by Government’s Decree No. 120/2011 /ND-CP) (“Decree 35”), Articles 17 and 17a (Viet.). (In 2018, the Vietnamese government issued Decree No. 08/2018/ND-CP (“Decree 08”) to remove the registration requirement under Article 5 of the Commercial Law on Franchising. However, the registration requirements are still applicable under Articles 17 and 17a. )

47. Section 54 of the Franchise Act 1998 (Act 590), amended by the Franchise (Amendment) Act 2012 (Act A1442) (Malay.).

48. Additional requirements may apply. See Ferdinand M Negre & Wesley K Rosales, Philippines, in FRANCHISING GLOBAL GUIDE, THOMSON REUTERS PRACTICAL LAW, supra note 24.

49. Thomas Mundry, Russian Federation, in FRANCHISING GLOBAL GUIDE, THOMSON REUTERS PRACTICAL LAW, supra note 24.
Post-sale registration also may be required, or recommended, under the franchise laws of a particular jurisdiction or under other jurisdiction-specific laws that affect franchises. In China, a franchisor must register within fifteen days following the first franchise sale. A franchise agreement with a Russian franchisee is not enforceable in Russia unless it is registered with the Russian trademark office. The Brazilian Central Bank will not permit royalty fees or other payments to be remitted abroad by a Brazilian franchisee under a franchise agreement unless that agreement is first registered with Brazil's intellectual property office. And, in Mexico, it has become accepted practice to register the franchise agreement (or a summary of the franchise agreement) post-sale with the Mexican Institute of Industrial Property (IMPI) to establish that the trademark is being used in compliance with the usage requirements under Mexico's Industrial Property Act.

Although not a disclosure or registration issue per se, the relationship provisions included in the franchise laws of certain jurisdictions may require modifications to the terms of the franchise agreement. For example, Mexico's Industrial Property Law sets forth twelve mandatory terms to be agreed upon by the parties and included in the written franchise agreement:

1. the relevant geographic area;
2. possible locations, minimum area, and characteristics of the infrastructure investment;
3. inventory, marketing, and advertising policies;
4. reimbursement, funding and consideration policies, proceedings, and terms;
5. criteria and methods to determine profit margin and franchisee’s commission;
6. description of technical and operational training, and the form or methods of technical assistance and services to be provided by the franchisor;
7. performance and quality of service supervision, information, evaluation, and qualification criteria, methods, and proceedings;
8. subfranchise terms and conditions;
9. grounds for termination (if unilateral termination is only allowed with proper cause, or if the contract has an indefinite term); and
10. grounds for reviewing or modifying terms and conditions.

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51. Grazhdanskii Kodeks Rossiskoi Federatsii [GK RF] [Civil Code] art. 1028 (Russ.).
53. For an excellent discussion of these and other post-sale activities that may be required under the laws of various jurisdictions, see Jeffrey A. Brimer, Thibault de Chatellus, Mark Forseth & Kevin E. Maher, After the Agreements Are Signed: Post-Closing Legal and Business Matters in International Franchise Transactions, 46th Int’l Franchise Ass’n Annual Legal Symposium (May 2013).
(11) unless agreed by the parties, there is no obligation for the franchisee to accept franchisor as a partner or to give shares in the franchisee; and
(12) unless agreed by the parties, there is no obligation for franchisee to sell its goods only to franchisor after the contract termination.

The relationship provisions of local franchise laws also may require changes in a franchisor’s procedures for transfer or termination as reflected in the franchise agreement. By way of illustration, the Korean Franchise Act includes a very detailed procedure for terminating franchise agreements. Generally, the KFA requires the franchisor to provide two written notices of breach and a two-month cure period (2-Notices-in-2-Months Rule). The cure period begins to run upon the provision of the first notice of breach. During the cure period, the franchisor must provide a second notice of breach. If the franchisee has not cured the default by the end of the two-month cure period (provided that two written notices of breach were given), the franchisor may then terminate the franchise agreement. There are certain statutory exceptions to this general 2-Notices-in-2-Months Rule for which the franchisor may terminate the franchise agreement immediately. Franchise agreement modifications are likely to be needed to reflect the statutory defaults allowing for immediate termination and to provide that all other listed defaults fall under the 2-Notices-in-2-Months Rule.

B. Variations in the Practice

As illustrated by the preceding discussion, franchise regulations in jurisdictions outside the United States vary widely. Yet, even in jurisdictions where the local franchise law requirements appear similar to those in the United States, important differences in practice may exist. Those differences can create significant risks for an ill-prepared U.S. franchisor.

Ontario’s Arthur Wishart Act (including its Implementing Regulations) requires franchisors provide

a prospective franchisee with a disclosure document and the franchisee shall receive the disclosure document not less than fourteen days before the earlier of (1) the signing by the prospective franchisee of the franchise agreement or any other agreement relating to the franchise; and (2) the payment of any consideration by or on behalf of the prospective franchisee to the franchisor or franchisor’s associate relating to the franchise.

56. Id.
57. Id.
58. Id.
59. Id.
60. Arthur Wishart Act, S.O, 2000, c.3, s. 5(1) (Can.).
This requirement is strikingly similar to the FTC Franchise Rule’s requirement for franchisors “to furnish a prospective franchisee with a copy of the franchisor’s current disclosure document . . . at least fourteen calendar days before the prospective franchisee signs a binding agreement with, or makes any payment to, the franchisor or an affiliate in connection with the proposed franchise sale.”

Both the Arthur Wishart Act and the FTC Franchise Rule also specify the information that must be included in the disclosure document provided to prospective franchisees, but with a critical difference. The FTC Franchise Rule contains a clear direction to franchisors limiting the information included in the FDD: “Do not include [in the FDD] materials or information other than those required or permitted by . . . [the Rule] or by state law not preempted by . . . [the Rule].”

In contrast, the Arthur Wishart Act includes an open-ended mandate: “The disclosure document shall contain . . . all material facts, including material facts as prescribed. . . .” This means that “[i]nformation disclosed must be complete and accurate as of the date of the disclosure document (except for certain information, such as financial statements, which must be current as of the end of the previous fiscal year).” And the risks of providing a deficient disclosure document are quite high, including the risk that a franchisee might exercise its right to rescind the franchise agreement, recover its investment, and claim damages.

As a result, U.S. and Canadian practitioners have developed distinctly different approaches to the franchise disclosure process. The general practice in the United States is for franchisors to prepare a Franchise Disclosure Document that satisfies the requirements of the FTC Franchise Rule (including applicable state-specific addenda addressing any additional Registration State requirements), taking into account the disclosure guidance provided by the FTC and state regulatory authorities. This FDD is the disclosure document that is provided to all prospective franchisees (following registration in the Registration States, if applicable), including to prospective purchasers in transfers of existing franchised locations and to existing franchisees who have the right, and elect, to renew their franchises.

Similar to the U.S. practice, the practice in Ontario is for franchisors to prepare a form of Canadian FDD that satisfies the requirements of the Arthur Wishart Act (Template FDD). But, unlike in the United States, local Canadian counsel have advised that the Template FDD is provided to a new prospective franchisee and starts the fourteen-day disclosure period running, only if a particular site for the franchise has not been identified. Even in that
circumstance, the Template FDD is subsequently supplemented, when a site is identified, by the issuance of a Statement of Material Change that includes material information about the site but that does not restart the fourteen-day waiting period. If, however, the franchise is being offered for an identified site, the Template FDD is customized prior to delivery to include material information about the site. Since transfers and renewals necessarily involve an identified site, in those transactions the franchisor delivers a customized FDD at the outset. If material information becomes known after the customized Canadian FDD is issued, the franchisor then also issues a Statement of Material Change.

In short, although the Ontario disclosure statute was based, in part, on the FTC Franchise Rule, and while the requirements of the two are quite similar, key differences exist, and those differences shape the disclosure practice in each jurisdiction. A franchisor not aware of the differences could easily find itself the subject of a disclosure-based claim and at risk of a franchisee’s demand for rescission and recovery of not only the amount of the franchisee’s investment but damages as well.

III. Consequences of Expanded International Franchise Regulation

A. Increased Costs

The proliferation of franchise regulation in jurisdictions outside the United States has significantly increased the up-front investment required to sell franchises internationally in compliance with those laws. Compliance can be a costly proposition both in terms of the time and money required to complete the transaction.

When selling a franchise outside the United States, U.S.-based franchisors have traditionally adapted their domestic agreements for use in other jurisdictions by “internationalizing” those agreements. Among other changes, this modification means adding provisions applicable to currency repatriation and compliance with laws regulating foreign corrupt practices and anti-terrorist activities; adding or adapting provisions allocating the responsibility for withholding taxes; and adapting the dispute resolution provisions of the agreements to provide for international arbitration. Franchisors also have had to consider additional jurisdiction-specific changes to their agreements to address non-franchise laws that have an impact on the franchise relationship or to reflect commercial practices in the jurisdiction. For example, local competition laws may require changes to the in-term or post-term non-competition provisions and may impact the enforceability of indemnification provisions and guarantee requirements. In addition, insurance coverage and terms common in the United States may not be available in the target jurisdiction.

66. Id.
But the overlay of franchise-specific regulation in a jurisdiction raises additional issues. As noted earlier in this article, the local franchise law may require the addition of specific franchise agreement terms or the modification of other terms to comply with the relationship provisions of the law. Other agreement changes may not be required, but may nonetheless be advisable in circumstances where the local franchise law imposes an obligation on, or allocates a risk to, one party or the other by default unless the parties’ agreement specifically addresses the issue in a different manner.

In the international disclosure jurisdictions, the preparation of a disclosure document that satisfies the requirements of the local franchise laws adds additional time and expense. And, as illustrated earlier, to prepare those disclosure documents, U.S. franchisors can anticipate they will have to do more than simply re-package the information they disclose in their U.S. FDDs. To satisfy the disclosure requirements of a particular non-U.S. jurisdiction, the franchisor may have to gather information not typically required to be disclosed in the United States and/or adapt, often at significant cost, information it has developed for the United States to conform to the regulatory requirements outside the United States.

The additional requirement in certain jurisdictions to register the franchisor, the disclosure document, and/or the franchise agreement before the sale serves to further increase both the financial cost of the transaction and the time needed to complete it. Among other things, preparing a registration application often requires the franchisor to file the core franchise documents, as well as a number of supporting documents designed to provide substantiating information about, for example, (1) the organization and good standing of the franchisor entity; (2) the franchisor’s right to license the intellectual property that is the subject of the franchise; and (3) the franchisor’s executives or other employees responsible for managing the franchise system or supporting the local franchisee. To be accepted for filing, documents submitted with the registration application may have to be notarized and legalized (including by apostille for any country that is a party to the Hague Convention) or consularized. Although these requirements are designed to ensure that the authenticated or certified documents are accorded full legal effect in the target jurisdiction, they can add significant time to the process of preparing the application. Once the application is filed, prosecuting it can also be time-consuming and expensive as the local regulatory authority often has, and exercises, the right to require additional or supplemental information in connection with its review of the documentation.

Requirements to translate one or more of the relevant franchise documents into the local language prior to filing or disclosure adds still more time and expense. Vietnam’s franchise laws require registration with the Ministry of Industry and Trade before beginning franchise activities and disclosure to the prospective franchisee at least fifteen working days before the franchise agreement is signed. All documents submitted with the registration application (including the application form, disclosure document, and supporting
documents) that are in a language other than Vietnamese must be translated into Vietnamese for filing.\(^\text{67}\) Recent changes to Brazil’s franchise law now mandate that the pre-sale disclosure document be in Portuguese.\(^\text{68}\) Translations also may be required in connection with filing requirements under local trademark laws or in order for the franchisee to remit payments abroad to the franchisor. As noted earlier in this article, it has become accepted practice in Mexico to file the signed franchise agreement (or a summary) with the IMPI to establish trademark usage in compliance with Mexico’s Industrial Property Law. Often, a dual column summary will be prepared for filing in both English and Spanish. In Russia, it is necessary to register a franchise agreement with a Russian franchisee with the Russian patent and trademark office (Rospatent) to enforce that agreement. No summary filing is permitted, and the full franchise agreement must be translated into Russian (and notarized and apostilled) for filing.\(^\text{69}\)

Changes to local regulations also can add considerably to the costs of compliance. They may be changes to the franchise regulations themselves (as occurred recently in Brazil), or they may be changes in other laws that have an impact on franchise regulatory compliance. Such changes can be made without prior notice and with little, if any, guidance from the local regulatory authority. For example, in 2018, Indonesia introduced a new online business licensing system (the Online Single Submission System or OSS).\(^\text{70}\) While applicable to more than franchising, the new system required foreign franchisors, for the first time, to obtain a business identification number and conditional business license through the OSS before proceeding with the franchise registration process. For some months, however, there was no reliable guidance on the OSS process and no available precedent for issuing a business identification number or business license to a foreign franchisor. The lack of readily accessible published guidance for compliance with the local laws makes it essential to engage experienced local franchise counsel.

While the up-front cost of international franchise sales has risen due to the proliferation of international franchise regulations, those regulations have also negatively impacted strategies previously used by franchisors to shift some of those costs to the local operator. In many jurisdictions, one of the consequences of the regulation is that the franchisor cannot collect an up-front fee or deposit from its prospective franchisee in order to help defray those initial costs. In a number of disclosure jurisdictions, no payment

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\(^{67}\) Vietnam’s franchise requirements are in (a) the Commercial Law, adopted on June 14, 2005; (b) Decree No. 35/2006/ND-CP dated March 31, 2006 (Decree 35), which was amended by Decree 20/2011/ND-CP dated December 16, 2011 (“Decree 120”); and (c) Circular No. 09/2006/TT-BTM of the Ministry of Industry and Trade dated May 25, 2006 (Circular 09). Decree 35 also requires that the franchise contracts must be made in Vietnamese, although execution of both Vietnamese and English language versions is recommended.

\(^{68}\) Lei No. 13,966, de 26 de Dezembro de 2019, art. 2, Diário Oficial da União [D.O.U.] de 27.12.2019 (Braz.).

\(^{69}\) Brimer, de Chatellus, Forseth & Maher, supra note 53.

\(^{70}\) Government Regulation No. 24 of 2018 (Indon.) (Electronic Integrated Business Licensing Services, issued and effective on June 21, 2018).
can be made to the franchisor until after disclosure has been made and the legally required waiting period has expired. The South Korean law is particularly strict, permitting receipt of initial franchise fees only after the disclosure document is registered, the prospect is disclosed with the registered disclosure document, and two months have passed after the earlier of execution of the franchise agreement or opening of the franchised unit.\footnote{71. Jae Hoon Kim & Sun Chang Lee, Korea, in GETTING THE DEAL THROUGH (Franchise) (Aug. 2019), https://gettingthedeleathrough.com/area/14/jurisdiction/35/franchise-south-korea.}

B. Increased Risk

Expanding a franchised brand across international borders has always presented certain risks. They include the risk that the brand will not be commercially successful in a particular jurisdiction due to differences in operating costs, local tastes, or other market-based factors. The inherent risk also exists that the operator selected to develop the brand in a particular jurisdiction will prove to be unable to do so successfully. And the general geopolitical risks that have the potential to threaten any international business expansion apply equally to the cross-border expansion of a franchised brand.

However, the adoption of franchise-specific regulations by multiple jurisdictions has resulted in the creation of additional risks distinct to franchised brands. First is the legal risk of non-compliance. Even inadvertent non-compliance with the local franchise law can lead to serious consequences. Statutory remedies in various jurisdictions include rights to invalidate the franchise agreement, rescind the transaction, and seek damages. For example, in Mexico, if a franchisor fails to make the disclosures required under the Industrial Property Law, or if any of the disclosures made are determined not to be truthful, the franchisee is entitled to bring a civil action to annul the franchise agreement, and recover all amounts paid by the franchisee to the franchisor and monies expended by the franchisee in its endeavors.\footnote{72. Jorge Mondragon, Mexico, in FRANCHISING GLOBAL GUIDE, Thomson Reuters Practical Law, supra note 24.} In addition, in the first year after execution of the franchise agreement, the franchisee may claim any damages and lost profits caused by the violation.\footnote{73. Id.}

Less obvious, perhaps, are the commercial risks that may arise from the very act of complying with a local franchise-specific regulation. As in the United States, much of international franchise regulation is designed to regulate the franchise sales process, requiring disclosure and, in some jurisdictions, registration, before the parties can legally sign binding agreements and before the franchisor can receive any money. Unlike in the United States, however, satisfying these requirements often requires transaction-specific disclosures and a significant up-front investment of time and money. Moreover, few, if any, exemptions allow a franchisor to bypass the full range of regulatory requirements or expedite the process. In the United States, the FTC Franchise Rule’s Sophisticated Investor Exemptions do not require an

FDD in transactions with prospects that have a presumed level of sophistication and bargaining power. But similar exemptions are not common internationally. Even when dealing with a very experienced prospect, a franchisor may be required to spend the time and money to develop a disclosure document that complies with local law, and to file and prosecute a registration application, before closing the transaction.

Nevertheless, these arrangements frequently involve multi-year commitments and significant investments in the brand by very sophisticated counterparties, resulting in highly negotiated transactions. The negotiations often proceed simultaneously with the regulatory process so that the transaction can be closed as soon as legally possible following satisfaction of all regulatory compliance obligations. A franchisor may find itself investing substantial time and money to advance its regulatory compliance obligations, only to lose the prospect during the course of the negotiations. The time and money required for compliance on the front end of an international transaction may also exert pressure on a franchisor to make concessions in the negotiations that it may not otherwise make to avoid walking away from a significant investment.

IV. International Expansion in a Complex and Changing Legal Landscape

International franchising is at an interesting crossroads. The commercial benefits of cross-border expansion continue to be compelling, but the proliferation of diverse and idiosyncratic franchise regulations across multiple jurisdictions has significantly increased the time, cost, and risk associated with that expansion.

And it is simply unrealistic to expect that all—or any—of the jurisdictions regulating franchising will cooperate in any meaningful way to coordinate their respective regulatory regimes as was done in the United States by federal and state regulatory authorities. A relatively recent examination of the issue by one of the leading franchise law practitioners concluded that franchisors can expect to see neither the elimination of different regulatory approaches in the foreseeable future, nor any attempt by individual jurisdictions to modify their regulatory regimes in ways that would allow franchisors to test the waters or to proceed under exemptions from some of the more burdensome aspects of the regulations, even when dealing with a sophisticated counter-party.74 We can expect that differences will remain and must work for clarity and additional guidance from the regulatory authorities in each jurisdiction.

But given the current regulatory environment, what strategies can a franchisor use to manage the costs and risks of international expansion? Here are some strategies that a prudent franchisor should follow.

74. Zeidman, supra note 24.
A. Know the Regulatory Landscape

Knowledge is vital. Franchisors that decide to undertake an international expansion program must not only educate themselves about the potential impact of a target country’s cultural differences, market-based challenges and geopolitical risks, they also must have some basic knowledge of whether the target jurisdiction regulates franchising and, if so, how. Entering into discussions with a prospect without at least a rudimentary understanding of the jurisdiction’s approach to franchise regulation opens the door to possible actions—such as the execution of binding preliminary agreements or the receipt of deposits—that could have significant negative consequences for the franchisor.

Until relatively recently, access to that type of knowledge could prove challenging as widely available resources were scarce; relationships with local counsel were often the best—and in some cases the only—way to source the required information. Today, however, numerous publications address international franchise regulations, some of which are cited in the notes to this article. These sources include online publications that can be used not only as a quick reference, but also to make a comparative analysis of different regulatory systems. These materials provide a useful starting point and can serve as an invaluable resource when used as an early warning system for spotting regulatory red flags in potential target jurisdictions.

Counsel for franchisors can also look to professional organizations like the ABA Forum on Franchising, the franchise committee of the International Bar Association, and the international committee of the International Franchise Association for more in-depth analyses of the regulatory requirements of various jurisdictions. Program materials addressing the legal issues that arise in international franchise expansion have become increasingly prevalent over the years as more companies have made international expansion an important part of their growth strategies and their in-house and outside counsel have developed expertise in the area. Membership in these organizations and attendance at their programs have the added benefit of providing opportunities to connect with others who practice in the area and who can serve as valuable resources.

Developing a network of experienced local counsel who practice in the area is also critical. As noted earlier in this article, new franchise laws, changes in existing franchise laws, and other developments in international franchise regulation are occurring frequently and at times with little or no advance publicity or warning. Alerts published by local counsel are often one of the first ways other practitioners learn of a new development. Being on the distribution list of local franchise counsel practicing in various jurisdictions is itself a good early warning system to have in place.

When a client does decide to enter a particular market, engaging with knowledgeable local counsel in the target jurisdiction is essential. They will have the most up-to-date guidance on how the jurisdiction’s regulations are then being interpreted and implemented, as well as access to the local
regulatory authority in the event additional guidance on particular ques-
tions is needed. It is especially helpful to work with local counsel who have
experience assisting other U.S. franchisors who have expanded into the local
market. Their understanding of the U.S. approach to various legal issues and
their ability to “translate” the U.S. approach for use in the local jurisdiction
can be invaluable.

B. Select Local Operators Thoughtfully

A company engaged in franchise sales in the United States will typically
prepare a disclosure document that complies with federal and applicable
state franchise disclosure laws, register the disclosure document as required
in one or more of the Registration States, and then market the franchise to
prospective franchisees. As posited in the introductory sections of this article,
that process works in large part due to the coordination of federal and state
disclosure requirements and the maturity of the U.S. franchise regulatory
practice. Compliance with federal and applicable state franchise regulations
can take place before identifying a prospective franchise purchaser because
the disclosure requirements are generally uniform and the costs and time to
prepare and register a compliant FDD are relatively predictable.

As also described in the earlier sections of this article, in many jurisdic-
tions outside the United States the time line for complying with the local
franchise regulations is often extensive and not easily predictable, and the
costs of compliance can be high. Moreover, in some jurisdictions those
requirements include a mandate not only to disclose information about the
franchise system generally, but also to disclose information relevant to the
particular opportunity that is being offered.

Given these differences, it is more typical internationally than in the
United States to first identify a potential local franchise operator and only
then move forward with the documentation necessary to comply with the
applicable local franchise regulations. But what does it mean to “identify” a
potential local operator? Clearly, the vetting process should include prelimi-
narily testing the prospect’s interest and obtaining some information about
its experience in the relevant business, including whether the prospect is a
franchisee of other U.S. franchise systems. However, additional due diligence
may be warranted before deciding to move forward with a particular candi-
date. There is often some reluctance on the part of a prospect to provide
detailed financial and corporate due diligence information early in the pro-
cess. That is understandable, and more detailed due diligence may be prop-
erly conducted only as the deal moves forward. However, before committing
significant resources to complying with the local franchise regulations in
anticipation of concluding an arrangement with a particular prospect, an
early screening of the prospect is advisable to identify any potential disqual-
ifying red flags, such as those relating to litigation, bankruptcy, adverse reg-
ulatory actions, criminal matters, or local political issues. Those screenings
can be conducted by outside vendors that routinely provide such services.
Although it is an additional cost, the screening can be a cost-effective way of assessing potential risks early in the process.

C. Consider the Appropriate Structure

The structure that a franchisor elects to use when expanding into another jurisdiction can affect compliance with local franchise regulations. Although this is not an article about how to structure an international franchise program, it is important from a compliance perspective to at least note that differences in compliance requirements may exist based on the type of structure that is adopted.

At a high level, a franchisor should consider whether it will engage in direct franchising into the target jurisdiction or whether it will adopt a master franchise model. In a direct franchise model, the U.S. franchisor will enter directly into agreements with all local operators, including unit franchise agreements and, when appropriate, development agreements. In a master franchise model, the U.S. franchisor will enter into a master franchise agreement with the local operator (the master franchisee), and the master franchisee will then enter into unit franchise agreements (and possibly development agreements) with other subfranchisees in the market to build out the franchise system in the local jurisdiction.

A number of factors will influence the franchisor’s decision to adopt a particular franchise model, including whether the unit economics can support a multi-tiered structure and whether the franchisor has the expertise and resources to provide significant ongoing in-market support. While compliance is not the only—or indeed the most important—consideration that factors into the adoption of a particular structure, the structure that is ultimately selected may reduce or eliminate the need to comply with some or all of a jurisdiction’s regulatory requirements for the offer and sale of franchises. These questions are not susceptible to generalizations because the outcome depends on the precise language and interpretation of the applicable local legal requirement and because the final structure must align with the parties’ commercial goals. But a couple of examples serve to illustrate the point.

The Korean Franchise Act requires a franchisor to register a disclosure document with the KFTC and provide the registered disclosure document to a prospective franchisee at least fourteen days before the prospective franchisee signs a franchise agreement. However, local counsel in South Korea have advised that the KFTC takes the position that the registration and disclosure requirements of the KFA do not apply to the grant of a master franchise by a foreign master franchisor to a Korean master franchisee if the master franchise agreement grants the master franchisee only the right to solicit subfranchisees, but not operate outlets, in South Korea. That position is perhaps best understood by examining the basic principles underlying the

KFA. In essence, the KFA is concerned with matters relevant to the operation of a franchised unit. Indeed, the definition of a franchise license under the KFA focuses on the franchisee’s contractual right to run the franchised outlet, and a franchisee is someone that holds a license granted by the franchisor to run the franchised unit.\(^76\) Importantly for purposes of this discussion, applying the KFTC’s interpretation of the KFA, a U.S. franchisor that enters into a master franchise with a Korean master franchisee would have no obligation either to register or to deliver a disclosure document to the Korean master franchisee if the master franchise agreement does not grant the master franchisee operating rights. Although it may not be commercially desirable—or feasible—to grant a master franchise that does not require the master franchisee to operate any of the outlets that are the subject of the grant, in the right situation the time and cost of concluding the master franchise arrangement could be significantly reduced by adopting the type of master franchise structure described. And, of course, the Korean master franchisee would be required to register and deliver the registered disclosure document to prospective subfranchisees in Korea when granting operating rights.

Under China’s franchise regulation,\(^77\)

[a] franchise must have three elements: (i) a franchisor, through an agreement, grants other operators (franchisees) the right to use the franchisor’s business-operating resources, including registered trademarks, logos, patents, and proprietary technologies; (ii) the franchisee conducts business under a uniform mode of operation; and (iii) the franchisee pays franchise fees according to the agreement.\(^78\)

The Chinese franchise regulations apply to franchising operations within China, including those involving a non-Chinese franchisor and a direct Chinese franchisee. However, a franchise arrangement between two offshore (non-PRC) entities would not be subject to the China franchise regulations. Under the first prong of the franchise definition, the franchise regulations also should not apply if one of the offshore entities (the franchisee) then establishes one or more wholly- or majority-owned subsidiaries (self-owned subsidiaries) in China and sublicenses the self-owned subsidiaries to operate the franchised units. The Chinese franchise regulations should be triggered only when the offshore franchisee or one of its Chinese self-owned subsidiaries subfranchises to other third-party operators in China.

As illustrated by the preceding examples, a franchisor’s compliance obligations may depend on how a transaction is structured. Each outcome is jurisdiction-specific and highly dependent on the wording and interpretation


of the relevant regulations. Although it is certainly not advisable to adopt a particular structure solely to lessen the burden of regulatory compliance, if a franchisor is able to accomplish its business objectives using a structure that reduces the time and cost associated with regulatory compliance, it may be beneficial to adjust the structure of the transaction.

D. Allocate Resources Wisely

Once a decision has been made to move forward in a jurisdiction with a specific local prospect under a particular structure, a franchisor may begin to consider how best to sequence the stages of the transaction. As the negotiations develop, the possibility always exists that the parties will fail to reach a meeting of the minds on the terms of the arrangement. One of the challenges in an international franchise transaction is to find ways to verify the parties’ agreement at various stages of the transaction while remaining in compliance with local regulations, but without incurring costs that may be disproportionate to the level of the parties’ commitment.

Traditionally, one way of seeking to verify that a prospective franchisee had a genuine level of commitment to the transaction was to require the prospect to pay a significant up-front fee or deposit against the initial fees that it would be required to pay on completion of the transaction. The payment helped to ensure that the prospect had an incentive to negotiate seriously and in good faith. However, as the earlier discussion of international franchise regulations explains, in many jurisdictions a franchisor is now prohibited from taking a fee or deposit before it is required to invest the time and money needed to satisfy the local franchise law, typically by preparing (and possibly registering) a disclosure document that complies with the local law and delivering that disclosure document to the prospect. In those cases, a franchisor must consider whether there are other ways to measure a prospect’s level of commitment at various stages of the transaction so that it can allocate—but not over-allocate—the appropriate level of resources to move the transaction forward in compliance with local laws commensurate with the prospect’s demonstrated level of commitment.

One way to test whether the parties have agreement on fundamental deal terms is to first negotiate a letter of intent (LOI). An LOI can perform an important function by allowing the parties at an early stage of the transaction to confirm they have a mutual understanding of the material terms of the proposed arrangement, including the territory and fees. An LOI also can serve to establish a definitive time period within which the parties agree to negotiate exclusively with one another in order to reach a full and final agreement on all terms of the transaction. Setting a clearly defined period of time for the negotiations can give the franchisor some assurance that the market under negotiation will not be tied up indefinitely if the franchisor and the prospect cannot agree on final terms. The regulatory question, of course, is whether an LOI can be signed before the franchisor complies with any applicable disclosure and registration requirements under the local franchise law. Not surprisingly, the answer varies depending on the jurisdiction.
As discussed in an earlier section of this article, under the Arthur Wishart Act, franchisors in Ontario must provide the disclosure document at least fourteen days before the earlier of payment of a fee or the prospective franchisee’s execution of “the franchise agreement or any other agreement relating to the franchise.” Under this standard, it is not clear that any LOI—even if expressly made non-binding—can be signed without triggering an obligation to disclose under the Ontario statute.

In contrast, under the KFA, the obligation to disclose is triggered by payment of any fee or execution of a franchise agreement. A franchise agreement is specifically defined as:

[A] continuous business relationship in which a franchiser allows its franchisees to use its own trade marks, service marks, trade names, signs, or any other business marks (hereinafter referred to as “business marks”) in selling goods (including raw materials and auxiliary materials) or services in conformity with certain quality standards or business methods, and supports, trains, and controls its franchisees in regards to their management, business activities, etc., and in which franchisees pay franchise fees to their franchiser in return for the use of business marks and the support and training provided for their management, business activities, etc.

Since an LOI would typically not fall within this definition of a “franchise agreement,” in South Korea it should be permissible to execute a binding LOI before providing disclosure, although the terms of the LOI should be reviewed to ensure they are consistent with local laws, including local franchise laws.

Once past the LOI stage, a franchisor also may wish to consider whether it is permitted under local franchise regulations to sign an even more significant agreement—such as a development agreement—before disclosure and registration (if required) are complete. Many U.S. franchisors structure their direct franchise programs to use both a development agreement and separate unit franchise agreements. The development agreement defines the territory within which the developer/franchisee will develop franchised units and includes a schedule that establishes the number of franchised units to be opened, and the dates for opening those units, in the territory. A separate unit franchise agreement is then signed for each unit opened under the development agreement.

It can be helpful from a commercial perspective to be able to sign the development agreement—if not the unit franchise agreement—before spending the time and money necessary to prepare (and possibly register) a franchise disclosure document, particularly if the local regulatory requirements are perceived to be time consuming and/or expensive. Because the

79. Arthur Wishart Act, S.O, 2000, c.3, s. 5(1)(a) (Can.). Proposed amendments to the Act include an exception for confidentiality agreements signed prior to disclosure, but, although the proposed amendments received Royal Assent in 2017, they have not been declared in force, and Ontario remains the only Disclosure Province without such an exception.

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A development agreement establishes the number of franchised units to be opened and the schedule for opening, it can serve as a good barometer for determining the parties’ mutual understanding of certain key terms, prior to investing the significant time and money required to prepare a disclosure document, register, and disclose. Early execution of a development agreement also allows the parties to begin the site selection and development process as quickly as possible.

Execution of a binding development agreement prior to delivery of a disclosure document that satisfies local franchise requirements may not be feasible in jurisdictions where the disclosure (and any applicable registration) obligation is triggered by a prospective franchisee’s execution of any binding agreement with the franchisor or its affiliate in connection with the proposed franchise sale. However, in jurisdictions that impose such requirements before a “franchise agreement” is executed, a franchisor may well ask whether its development agreement is a “franchise agreement” under the local franchise law. If not, it may be possible for the parties to sign the development agreement and begin the site selection process while the franchisor contemporaneously prepares (and, where required, registers) a disclosure document that covers only the unit franchise agreement.

As with all questions involving the legal effect of local franchise regulations, the answer will depend on the wording of the applicable requirement and its interpretation. The development agreement analysis is arguably more nuanced than the LOI analysis in that the development agreement grants certain rights to the developer/franchisee, but typically does not grant rights to use the franchisor’s trademarks or to operate franchised units. Those rights are usually granted only in the unit franchise agreement, which may be referenced in the development agreement. Often, the answer is not “black and white,” and a franchisor will have to determine whether the benefits of signing a development agreement before disclosing and/or registering outweigh the potential risks.

For example, under the KFA, the recommended approach is to register and disclose before entering into a development agreement with a prospect. The reason is that signing a development agreement contractually obligates the prospect to sign a franchise agreement at a later date, which would result in the formation of a franchisor-franchisee relationship. Nevertheless, there is a position that registration and disclosure may not be required before signing the development agreement. As discussed in an earlier section of this article, the KFA’s definition of a franchise license or right focuses on the franchisee’s right to operate a franchised unit. Thus, it is arguable that the right to develop, but not operate, franchised units falls outside the scope of the KFA. If a franchisor wishes to take that position, it is well advised to restrict the terms of its development agreement to those related to the grant of development rights and to state clearly in the development agreement that the franchise agreement (and only the franchise agreement) governs all operating rights. In addition, because the KFA’s definition of a franchise fee
is very broad,\textsuperscript{81} and because the KFA places significant restrictions on when a franchise fee may be paid,\textsuperscript{82} payment of any development or territory fee should be deferred until payment can be made in compliance with the KFA’s provisions governing payment of the franchise fee. Although the risks attendant to execution of the development agreement in advance of registration and disclosure cannot be completely eliminated, we have received advice that the most probable consequence for the franchisor would be a corrective order from the KFTC mandating registration of the FDD and undertaking future compliance. Neither the development agreement nor the franchise agreement should become invalid because the development agreement was signed before registration or disclosure.

\textbf{V. Conclusion}

Since I first began practicing franchise law, international franchise expansion has become increasingly complex, time consuming, and expensive. A significant contributor to those trends has been the ever-increasing number of regulations adopted by many non-U.S. jurisdictions to regulate franchising activities. The proliferation of those regulations is not likely to end soon, and this article was intended to suggest some strategies that may help franchisors expanding into multiple regulated jurisdictions to manage the attendant costs and risks.

The article was planned, and much of it was written, before the widespread outbreak of the COVID-19 virus disrupted franchise system operations worldwide. The virus, and the lockdowns of many franchised businesses mandated in response to the virus, will likely have a long-term impact on many franchisors’ plans for future international expansion. However, as global growth rebounds, as surely it must, the principles discussed in this article should continue to have validity for franchisors that decide to access the international markets.

\textsuperscript{81} Fair Franchise Transactions Act, Act No. 6704, May 13, 2002, amended by Act. No. 14135, Mar. 29, 2016, art. 2 (S. Kor.) (“Franchise Fee” includes consideration that a franchisee pays to a franchiser (a) in order to obtain a franchise license, including a license for the use of business marks, or to receive support for and training on his/her business activities, such as membership fees, admission fees, franchise fees, training fees, or down-payments; (b) as a security for the payment of obligations or damages incurred in connection with the purchase price for commodities, etc. supplied by the franchiser; (c) as the price for fixture, facilities, or commodities supplied or a rent for real estate provided by the franchiser at the time a franchise license is granted in order to start a franchise business; (d) on a regular or irregular basis, for the use of business marks licensed under an agreement with the franchiser, support for and training on business activities, etc., and that is specified by Presidential Decree; and (e) any other consideration that a prospective franchisee or a franchisee pays to a franchiser to acquire or maintain a franchise license.).

\textsuperscript{82} Id. chap. III (restricting receipt of “initial franchise fees” prior to (1) disclosure of registered FDD, and (2) two months after signing the FA or opening of the franchised unit, whichever comes earlier).