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GOING INTERNATIONAL: WHAT ADDITIONAL RESTRAINTS WILL YOU FACE?

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I. INTRODUCTION

When a franchisor makes the decision to expand outside its home country into another country, the franchisor and its counsel should not assume that foreign laws are similar to U.S. laws governing franchise relationships. As this paper will highlight, the laws of other countries differ significantly from U.S. law, both in terms of subject matter and how they are applied.

The United States, Canada, United Kingdom, Australia, India and other countries that are or were part of the British Commonwealth have a legal system based on the common law. Most of all the other countries in the world follow a civil law system. A common law legal system has the following defining features:

- Legislation and particularly court decisions address specific issues and situations and are not aimed at setting down broad principles;
- Court decisions have binding effect on lower courts; and
- The common law is based on oral presentations and cross examinations.

By contrast, in a civil law system, which derives from Roman law, legislation is in the form of codes which lay down broad principles, the concept of precedent established by court cases is largely unknown and procedures are based largely on written materials.[1]

Identifying the laws that may be applicable to international franchise relationships is not a matter as simple as checking the "International Laws" section of the CCH Business Franchise Guide to determine if a country has a franchise registration or disclosure law. For example, U.S. and foreign laws other than those specifically directed at franchise relationships may apply to certain types or aspects of international franchise agreements. The laws may include corruption and bribery, consequences of receiving the proceeds of crime, competition laws, disclosure requirements, data protection, contract termination, good faith and other regulatory issues.

This paper will discuss many of these laws and regulations with a focus on U.S., U.K. and certain European Union jurisdictions.

II. CORRUPTION AND BRIBERY

A. U.S. Laws - Foreign Corrupt Practices Act

The Foreign Corrupt Practices Act ("FCPA") is a U.S. federal law that regulates the way U.S. companies conduct foreign business. The FCPA has two main sections: (1) anti-bribery provisions and (2) books and records provisions.[2] The anti-bribery provisions prohibit offering or

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[1] *See* John H. Pratt and Luiz Henrique O. do Amaral, *Civil Law for Common Law Practitioners (Or How to Draft an Agreement for Use Overseas)*, 25th Annual Forum on Franchising (2002), at 1-2. *Also see* Section I.A.2.

[2] 15 U.S.C. §§ 78dd – 1, *et seq*.

giving anything of value to a public official or political candidate (directly or indirectly) to obtain or retain business or to obtain an improper advantage in doing business. The books and records provisions require that public companies maintain proper internal books and records that reasonably reflect all transactions and dispositions of assets. The books and records provisions also mandate internal accounting controls to ensure that expenditures are authorized.

The FCPA applies broadly to: every U.S. citizen or U.S. resident alien (whether in the U.S. or not); U.S. companies (including non-U.S. subsidiaries controlled by a U.S. company); foreign companies with employees in the U.S.; foreign nationals acting for U.S. companies; and third parties hired by the above (agents, consultants, representatives, distributors, etc.). The FCPA holds parent companies strictly liable for the actions of their majority-owned and controlled subsidiaries (including foreign subsidiaries) and imposes a good-faith obligation with respect to the actions of non-majority-owned and non-controlled subsidiaries.[3] Although to the authors' knowledge there are no reported cases of FCPA enforcement actions against a franchisor for the actions of its foreign franchisees, franchisors should be aware that U.S. companies are responsible for ensuring that improper payments are not made indirectly through others (including, potentially, franchisees, master franchisees or vendors). The FCPA anti-bribery violations can be based on the wrongful acts of others under the FCPA's third-party payment provisions.

The FCPA defines "foreign officials" to include government employees, employees of state-owned enterprises and private persons "acting in official capacity." Even if an enterprise is not wholly-owned by the state, it may fall under the purview of the FCPA if a non-U.S. government exercises substantial control over its operations. The term "foreign official" also includes candidates for foreign office and foreign political parties, as well as spouses, dependents and siblings of any person otherwise falling within the "foreign official" definition.

The prohibition on giving "anything of value" in the FCPA covers "payments" ranging from expensive gifts or entertainment expenses to non-essential travel costs and improper campaign contributions. The "improper advantages" in doing business that are covered by the FCPA might include avoiding the payment of taxes or duties, preventing adverse government actions, obtaining regulatory approvals or renewing or retaining contracts. Note that payment does not have to be actually made, and the bribery does not have to be successful in order to constitute an FCPA violation.

There are limited and specific exemptions to the FCPA for nominal payments related to non-discretionary government actions, but these exceptions are very narrow. The payments that may be permissible are:

(1) A bona fide and reasonable payment that is directly related to the promotion, demonstration or explanation of products or services, or directly related to the execution or performance of a contract, such as travel and lodging reimbursement.

(2) A small payment (relative to the country or area in which the payment is made) that serves only to expedite or to secure "routine governmental action," such as

[3] See 15 U.S.C. § 78m(b)(6).

securing basic services such as telephone, water and mail, processing visas, or obtaining permits or police protection; or

(3) A payment that is expressly permitted by local law (however, all local laws are construed to prohibit bribery).

Any company relying on these exceptions must understand that the exceptions are read and applied very narrowly. In addition, to avoid a violation of the books and records provisions of the FCPA, a company must accurately record all such payments made by it or its subsidiaries or agents.

The penalties for violation of the FCPA include both criminal and civil sanctions. Criminal penalties are imposed by the Department of Justice ("DOJ"). For anti-bribery violations, criminal penalties for individuals may include fines up to $100,000 per violation and imprisonment up to five years. For entities, fines are up to $2,000,000 per violation (or more under alternative fine rules. Criminal penalties for books and records violations are, for individuals, fines up to $5,000,000 per violation and imprisonment up to 20 years and, for entities, fines up to $25,000,000 per violation (or more under alternative fine rules).

Civil penalties for the anti-bribery provisions are imposed by the Securities and Exchange Commission ("SEC") and, for privately-held companies, the DOJ. The fines for an officer, director, employee or agent are fines of up to $10,000 per violation for any willful violation. For entities, fines are up to $10,000 per violation and injunctions. The SEC may seek an additional fine of up to $500,000 on the gain obtained as a result of the violation.

In addition to the monetary penalties, other consequences of FCPA violations can include: being barred from participating in government procurement contracts, being barred from receiving State Department export licenses, being barred from participation in certain government agency programs (such as the Overseas Private Investment Corporation), loss of corporate goodwill, and negative publicity.

In addition, for public companies, because FCPA violations are categorized as a type of fraud, a company's failure to disclose an FCPA violation may itself trigger a Sarbanes-Oxley Act ("SOX") violation. For example, Section 302 of SOX (certification of financial statements by CEOs and CFOs) requires a company's auditors and board of directors to disclose any fraud, whether or not material, involving persons with a significant role in corporate internal control. Similarly, Section 404 of SOX (internal control procedures) requires a company to report on internal controls with respect to all of its consolidated subsidiaries, including minority-owned subsidiaries.

Record keeping violations generally include: records that fail to record improper transactions at all (i.e., "off-the-books" transactions such as bribes and kickbacks); records that are falsified to disguise aspects of improper transactions otherwise recorded correctly; or records that set forth the financial facts, but fail to include qualitative aspects such as the true purpose of the payment.

The FCPA does not require proof of actual knowledge. A person may be liable for an FCPA violation if a reasonable person under similar circumstances would know that a violation is highly probable. Red flags that might put a company on notice of prohibited activity include:

- A request for an unusual method of payment to any participants in the transaction, particularly through third countries or in third country currency;
- Known or suspected family relationship between any participants in the transaction and government officials;
- Refusal by any participant to sign affidavits or make representations that they will not violate the FCPA;
- Requests for payment disproportionate to the services performed;
- Known or suspected misrepresentations by the agent or others in connection with a proposed transaction;
- Requests by any participant in the transaction that the company prepare false invoices or any other type of false documentation; or
- Any negative information developed as part of an independent investigation into the activities and reputation of the agent or other participants in the transaction.

The frequency and severity of SEC and DOJ enforcement of the FCPA has increased in recent years with cases resulting in higher fines and more jail time. In addition, the U.S. government is increasingly cooperating with foreign enforcement authorities on bribery and corruption issues, so it is possible that violators face prosecution and sanctions in multiple countries.

B. UK and EU laws – The Bribery Act 2010

The UK Bribery Act was passed in April 2010 and became effective on July 1, 2011[4]. Its purpose was to modernize the outdated and complex legislation that previously regulated this area.

1. Similarity with FPCA

Very much like the FCPA, the Bribery Act has extensive extra-territorial application that affects many international companies including, of course, franchise systems. The application of the Bribery Act is considered to be even more far reaching than the FCPA not only because of its territorial scope but also because it applies to offenses committed between private individuals and companies and not just where a public official or public body is involved.

The Bribery Act applies to all UK companies, partnerships and nationals, foreign individuals ordinarily resident in the UK and foreign corporate bodies carrying on a business or part of a business in the UK irrespective of whether the offense is performed within the UK or anywhere else in the world. The FCPA is narrower in its application.

Perhaps the biggest difference in scope between the two Acts is that whereas the Bribery Act applies to bribery both domestically as well as abroad, the FCPA only applies to bribery involving foreign officials. U.S. domestic bribery is covered by other laws.

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[4] Bribery Act, 2010, c. 23 (Eng.) (the "Bribery Act"). The Bribery Act can be accessed at http://www.legislation.gov.uk/ukpga/2010/23/contents.

Passive bribery is expressly prohibited by Section 2 of the Bribery Act.[5] Companies and their agents, therefore, need to be wary of inadvertently accepting bribes. Although under the FCPA only those giving a bribe would be committing an offense, the Bribery Act prohibits both – giving and receiving bribes.

When it comes to facilitation payments – payments made to facilitate transactions, supplies or governmental clearances – the UK takes a different approach from the U.S. Facilitation payments are illegal under English law. Unlike the FCPA, the Bribery Act does not contain an express exception for such payments.

Breach of the Bribery Act can give rise to maximum prison terms of 10 years for individuals and unlimited fines for corporate entities - a more severe punishment when compared with the FCPA. Under the FCPA the maximum prison sentence that can be imposed is 5 years and the maximum fine is $2,000,000.

Because the Bribery Act and the FCPA are different in a number of important respects, U.S. franchisors who are currently FCPA compliant will need to review their policies and procedures to ensure that they are also compliant with the Bribery Act and should not assume that bribery and anti-corruption laws outside the U.S. are less stringent than the FCPA.

2. Offenses of Bribing Another Person

Section 1 – General Bribery Offenses – apply to both domestic and foreign bribery and to both the bribery of foreign officials and commercial bribery.[6]

A person or corporate entity is guilty of an offense under Section 1 of the Bribery Act where he "promises or gives financial or other advantage to another person" with the intention to bring about the "improper performance by another person of a relevant function or activity or to reward such improper performance". A Section 1[7] offense is also committed where a person "knows or believes that the acceptance of the advantage offered, promised or given in itself constitutes the improper performance of a relevant function or activity."[8]

"Improper performance" is defined in Section 4 and means "performance which amounts to a breach of an expectation that a person will act in good faith, impartially or in accordance with a position of trust" and covers both the public and private sectors**.**[9]

3. Bribery of a Foreign Official

Section 6 is a separate stand-alone offense of bribing a foreign pubic official. The offense is bribing a foreign public official with the intention of influencing the official in the

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[5] Bribery Act §2.

[6] Bribery Act §1.

[7] Bribery Act §1(2)(b).

[8] Bribery Act §1(3)(b).

[9] Bribery Act § 4(1) & 4(2).

performance of his or her official functions.[10] No offense occurs, however, where local legislation permits the official to receive financial or other advantage.

The definition of a 'foreign public official' covers any official whether elected or appointed who holds a legislative, administrative or judicial position or who performs public functions for any public agency or enterprise, government or international organization.[11]

Franchisors who are planning to expand to countries that are either known or considered to be corrupt, or where making a payment to a government official is the norm, will have to be even more careful and ensure that adequate procedures are in place to ensure that their employees, master franchisees and others do not offer or receive bribes.

4. <u>Failure of Commercial Organizations to Prevent Bribery.</u>

By virtue of Section 7 "a commercial organization will be liable to prosecution if a person associated with it bribes another person".[12] This is a new strict liability offense that applies to companies and partnerships alike and to both those incorporated or formed in the UK as well as those incorporated or formed outside the UK. Foreign companies or partnerships must be carrying out a business or part of their business in the UK in order for the Act to apply but, for instance, U.S. law firms with an office in London will be regulated by the Bribery Act. Recent guidance[13] published by the UK Government (the "Guidance") provides that "a common sense approach" must be used to determine whether or not a company or partnership can be regarded as having business presence in the UK. The Guidance does however confirm that presence will require more than for example mere presence on the stock market or the fact that a parent company might have a subsidiary in the UK. A subsidiary can act independently of its parent as can franchisees. Accordingly, simply having a franchisee, developer or master franchisee in the UK will not create a presence in the UK.

An "associated" person is defined as a "person who performs services for and on behalf of an organization".[14] Generally speaking, franchisees do not perform services for and on behalf of their franchisor but perform services on their own behalf and so will not be "associated" for the purposes of Section 7. An exception to this is where franchisors obtain national account contracts or require customer contracts to be entered into between the franchisor and the ultimate customer and franchisees perform those contracts as agents of the franchisor.

If a franchisee is treated as "associated", the franchisee must also make a bribe with the intention of obtaining or retaining business for the franchisor for an offense to be committed by the franchisor. Again, generally franchisees obtain and retain business for themselves and not their franchisor.

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[10] Bribery Act §6(1).

[11] Bribery Act §6(5).

[12] Bribery Act §7(1).

[13] Ministry of Justice, The Bribery Act 2010 – Guidance (2011), which can be downloaded from www.justice.gov.uk/guidance/making-and-reviewing the laws/bribery.htm.

[14] Bribery Act §8.

There is a defense to this Section, namely, if adequate procedures have been put in place designed to stop corruption. The Act does not set out what constitutes "adequate" procedures but the Guidance indicates that these should be proportionate to the risk, nature, scale and complexity of the organization's activities. Moreover, they must also be clear, practical, accessible, effectively implemented and enforced.

For the foregoing reasons, franchisors, as part of the growth and expansion of their systems into new countries, should routinely carry out a risk assessment and due diligence, to ensure that all relevant documentation such as operations manuals and franchise agreements contain an express prohibition of bribery, introduce a procedure for dealing with bribery issues, include anti-bribery and anti-corruption in the training offered to franchisees and their employee and monitor and enforce those procedures as necessary.

C. <u>Organization for Economic Co-operation and Development Anti-Bribery Convention</u>

The Organization for Economic Co-operation and Development ("OECD") is a multinational organization whose purpose is to provide a forum in which governments can work together to share experiences and seek solutions to common problems. The OECD has thirty-four member countries, including the United States, United Kingdom, Canada and most European countries. The OECD works with governments to understand what drives economic, social and environmental change. It measures productivity and global flows of trade and investment. It also analyzes and compares data to predict future trends and sets international standards on all sorts of things, from the safety of chemicals and nuclear power plants to the quality of cucumbers.[15]

The OECD Council approved the updated text of its Guidelines for Multinational Enterprises (the "Guidelines") on May 25, 2011.[16] According to the OECD, the "Guidelines are recommendations addressed by governments to multinational enterprises operating in or from adhering countries. They provide voluntary principles and standards for responsible business conduct in areas such as employment and industrial relations, human rights, environment, information disclosure, combating bribery, consumer interests, science and technology, competition, and taxation."[17] Although they are voluntary and not legally enforceable recommendations, the member countries have made a binding commitment to implement the principals and standards and encourage their use.

Chapter VII of the updated Guidelines is a totally revised chapter on "Combating Bribery, Bribe Solicitation and Extortion," which incorporate earlier recommendations from the OECD. It provides that:

- [Multinational] Enterprises should not, directly or indirectly, offer, promise, give, or demand a bribe or other undue advantage to obtain or retain business or other

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[15] For more information on the OECD, *see* http://www.oecd.org.

[16] The original Guidelines were adopted by the OECD Council in 1976. The recent update was the fourth update since their original adoption. A copy of the updated Guidelines can be found at http://www.oecd.org/dataoecd/43/29/48004323.pdf. For more information on the history of the Guidelines, *see* www.oecd.org/daf/investment/guidelines.

[17] *See,* http://www.oecd.org/department/0,3355,en_2649_34889_1_1_1_1_1,00.html.

improper advantage. Enterprises should also resist the solicitation of bribes and extortion.

- The Guidelines then list activities that multinational enterprises should follow to implement the Guidelines. The Guidelines state that "[t]he adoption of appropriate corporate governance practices is also an essential element in fostering a culture of ethics within enterprises."[18]

III. CRIMINAL AND ANTI-TERRORISM LAWS

A. U.S. Laws

1. Specially Designated Nationals and Blocked Persons Lists

The Office of Foreign Assets Control ("OFAC"), an agency of the U.S. Department of the Treasury, administers and enforces economic sanction programs against groups of individuals (such as terrorists and narcotics traffickers) and against countries and governments. These laws apply to U.S. companies and can also apply to affiliates, foreign subsidiaries, employees and other related persons depending on the circumstances.

The programs administered by OFAC include the Specially Designated Nationals list ("SDN List"), which identifies an ever-expanding list of individuals and organizations with whom U.S. companies are prohibited from doing business. A convenient listing of the various lists of prohibited persons – appropriately titled "Lists to Check" – is available on the U.S. Department of Commerce website at http://www.bis.doc.gov/complianceandenforcement/liststocheck.htm. The lists are updated periodically with new persons being added.

In addition to the due diligence performed at the outset of a business relationship, franchisors should establish a compliance program to ensure ongoing compliance with their obligations under the U.S. anti-terrorism and sanction programs. A compliance program should include at a minimum representations in the agreement that the franchisee is not listed on any of the prohibited lists, periodic certifications from the franchisee confirming compliance, and a right to terminate the agreement should the franchisee or its owners or affiliates ever appear on any prohibited lists.

2. Anti-Boycott Laws

Franchisors operating internationally should also be aware of their obligations under U.S. anti-boycotting laws. The U.S. anti-boycotting laws, namely, the 1977 amendments to the Export Administration Act ("EAA") and the Ribicoff Amendment to the 1976 Tax Reform Act ("TRA")[19], discourage, and in some cases prohibit, U.S. companies from participating in or supporting foreign boycotts not sanctioned by the U.S. government.

The anti-boycotting laws are of particular importance for any company doing business in the Middle East given that many countries in that region support the Arab League boycott of Israel. This Israeli boycott is not supported by the U.S. government and compliance with this

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[18] *See* Guidelines at page 45.

[19] 26 U.S.C § 999.

boycott by U.S. entities or individuals violates U.S. laws or may be penalized under the TRA. The U.S. Department of the Treasury publishes a quarterly list of boycotting countries, which as of May 2011 include: Kuwait, Lebanon, Libya, Qatar, Saudi Arabia, Syria, United Arab Emirates, and the Republic of Yemen. Iraq is not currently on the list, but the latest notice indicates that its status with respect to future lists remains under review by the Department of the Treasury.

Actions that may be penalized or prohibited under the anti-boycott laws include:

- Agreements to refuse or actual refusal to do business with or in Israel or with blacklisted companies;
- Agreements to discriminate or actual discrimination against other persons based on race, religion, sex, national origin or nationality;
- Agreements to provide or actually providing information about business relationships with or in Israel or with blacklisted companies; or
- Agreements to provide or actually providing information about the race, religion, sex or national origin of another person.

Additional examples of permitted and prohibited activities in connection with boycott requests are included in the Export Administration Regulations.[20]

Any requests made to U.S. entities or individuals to comply with the boycott must be reported to the U.S. Department of Commerce on a quarterly basis and to the IRS on an annual basis. Criminal and civil penalties can be imposed for violations of the anti-boycott regulations and failure to file the required reports. In addition, cooperation with or participation in an international boycott may result in a company losing certain tax benefits (for example, foreign tax credits or deferral of taxation of earnings of a controlled foreign corporation).

3. Money Laundering Regulations

Money laundering is the process of disguising the sources, changing the form, or moving the funds obtained through some form of criminal activity, including illegal arms sales, smuggling, drug trafficking and prostitution, to a place where the funds are less likely to attract attention.[21] The U.S. has enacted a variety of legislation aimed at curtailing money laundering. These include:

- Title 31, USC Section 5331, which was passed in 2001 as a result of the USA Patriot Act and duplicates the reporting provisions of IRC, Section 6050I (Form 8300). Dual reporting of this information will now be made to both the IRS and the Treasury Department's Financial Crimes Enforcement Network ("FinCEN").
- Title 31 USC Section 5332, the Bulk Cash Statute, was also enacted a result of the USA Patriot Act. Under this Act, U.S. Immigration and Customs Enforcement – Homeland Security Investigations, a division of the Department of Homeland

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[20] *See* 15 C.F.R. § 760.2

[21] For more information on money laundering and governmental activities to halt the practice, *see* the Financial Action Task Force website at: http://www.fatf-gafi.org/pages/0,3417,en_32250379_32235720_1_1_1_1_1,00.html.

Security, has jurisdiction to investigate violations of this statute. This affects anyone who transports or attempts to transport currency or other monetary instruments of more than $10,000 from a place within the United States to a place outside of the United States or from a place outside the United States to a place within the United States, and knowingly conceals it with the intent to evade the reporting requirements of 31 USC Section 5316.

- Title 18 USC Section 1960 gives the IRS the jurisdiction to investigate violations of this statute, which requires money service businesses to be registered with the federal government.

- Bank Secrecy Act – The Currency and Foreign Transactions Reporting Act, Public Law No. 91-508, Title II, along with financial institution record-keeping requirements, became known as the Bank Secrecy Act ("BSA"). The BSA mandates the reporting of certain currency transactions conducted with a financial institution (Form 4789), the disclosure of foreign bank accounts (TD F 90-22.1), and the reporting of the transportation of currency exceeding $10,000 across United States borders (Form 4790).

- Money Laundering Control Act of 1986 – Criminal Investigation investigates and recommends criminal prosecution for violations of Title 18, USC, Sections 1956 and 1957. These statutes make it illegal to conduct certain financial transactions with proceeds generated through specified unlawful activities, such as narcotics trafficking, Medicare fraud and embezzlement, among others.

- Asset Forfeiture – The asset forfeiture program is one of the federal government's most effective tools against drug trafficking, money laundering, and organized crime. In conjunction with other federal, state, and local law enforcement agencies, Criminal Investigation uses asset forfeiture statutes to dismantle criminal enterprises by seizing and forfeiting their assets. Most of Criminal Investigation's seizures and forfeitures are the result of Title 18 and Title 31 money laundering and currency investigations.

These laws are significant to franchisors because they can be held civilly and criminally liable if their international master franchisees and developers use the payment of fees under their agreement to launder money in violation of any of these acts. It probably goes without saying that any attempt by a party in another country to pay fees due to a franchisor in cash should be looked at very carefully and, where required, reported to the U.S. Government.

4. <u>OFAC Country Sanction Programs</u>

OFAC also administers sanction programs that target specific countries and governments. The scope of the sanctions and prohibited activities varies depending on the country. For example, in some cases, exports of certain items to the country are permitted if the company has a license from OFAC or the Department of Commerce. In other cases, there are different limits on exports to and imports from a particular country or the sanctions relate to specific groups or people. There are also some exceptions for humanitarian relief and other limited situations. As of July 2011, current programs include sanctions related to the following countries or regimes:

- The Balkans
- Belarus
- Burma (Myanmar)
- Cote D'Ivoire (Ivory Coast)
- Cuba
- Democratic Republic of Congo
- Iran
- Iraq
- Lebanon
- Liberia (former regime of Charles Taylor)
- Libya
- North Korea
- Somalia
- Sudan
- Syria, and
- Zimbabwe.

Cuba, Iran, Sudan and Syria are also listed by the U.S. State Department as state sponsors of terrorism. OFAC also administers sanction programs targeting counter-terrorism, counter-narcotics, diamond trading and non-proliferation. Details of the various sanction programs are available on the OFAC website.[22]

B. UK and EU Laws

Money laundering is regulated in the UK. It involves concealing the identity of illegally obtained money so that it appears to have come from a lawful source. There are three stages involved in the process: placement, layering and integration. Placement is the physical disposal of cash proceeds derived from illegal activity. Layering is the structuring of complex layers of financial transactions to conceal the source of funds. Integration is the act of providing apparent legitimacy to the proceeds of crime by returning them into the economy as bona fide business funds. The purchase of a franchise could be a good way of "integrating" funds so franchisors do need to be on their guard.

The key money laundering offenses in the UK are contained in the legislation discussed in this section.

1. The Proceeds of Crime Act 2002 ("POCA")[23]

A person commits a money laundering offense under POCA if he:

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[22] http://www.treasury.gov/resource-center/sanctions/Programs/Pages/Programs.aspx.

[23] Proceeds of Crime Act, 2002, c.29 (Eng.).

- Conceals, disguises, converts or transfers criminal property, or removes criminal property from the United Kingdom.[24] Concealing or disguising includes concealing or disguising its nature, source, location, disposition, movement or ownership, or any rights with respect to it;[25]

- Enters into or becomes concerned in an arrangement that he knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person;[26]

- Acquires, uses or has possession of criminal property.[27]

The above offenses apply to the proceeds of any criminal conduct and there is no *de minimis* limit. Therefore, even seemingly small transactions can result in a money laundering offense. "Suspicion"[28] requires the defendant to think that there is a possibility that the relevant facts exist. A vague feeling of unease is not sufficient but nor must the suspicion be "clear" or "firmly grounded and targeted on specific facts".[29]

The definition of criminal property is wide and encompasses any person's benefit from criminal conduct or any property that represents such benefit where the alleged offender knows or suspects that it constitutes or represents such a benefit.

Criminal conduct is defined as conduct that constitutes an offense in any part of the UK if it were to occur there.[30] This is a particularly important consideration for international franchisors because an activity in the franchisor's country that is lawful may not be lawful in the UK.

There are two defenses to the money laundering offenses: first that a person does not know or suspect that the property is criminal property;[31] the second is that a person either (a) makes a report to the Serious Organized Crime Agency ("SOCA") before the act is carried out, in which case the person concerned must wait for SOCA's consent to proceed or, where the act has already happened, as soon as practicable afterwards[32] or (b) intended to make such a report and had reasonable excuse for not doing so.[33]

Other offenses include failing to disclose money laundering activities and telling a person that disclosure has been made about them.

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[24] POCA §327(1).

[25] Id. §327(3).

[26] Id. §328(1).

[27] Id. §329(1).

[28] Id. §328(1).

[29] *Squirrell Ltd v National Westminster Bank plc,* [2006] 1 WLR 637

[30] POCA §340(2).

[31] Id. §340(3)(b).

[32] Id. §327(2)(a) .

[33] Id. §327(2)(b).

2. Money Laundering Regulations 2007[34]

The aim of the 2007 Regulations is to require relevant persons[35] to maintain certain policies, systems and procedures to prevent their business being used to facilitate money laundering in any way, either where business relationships are entered into or where one-off transactions are carried out.

The 2007 Regulations specify customer due diligence ("CDD") measures that are required to be carried out and the timing of such measures, along with actions that are required if the CDD measures are not carried out.

The CDD measures that must be carried out include:

- Identifying the customer and verifying his identity;
- Identifying the beneficial owner, where relevant, and verifying his identity;
- Obtaining information on the purpose and intended nature of the business relationship.[36]

These measures must be carried out before establishing a business relationship or the carrying out of the subject transaction.

Failure to comply with the 2007 Regulations is punishable by a maximum of 2 years imprisonment, a fine or both.

3. The Terrorism Act 2000

The Terrorism Act of 2000 ("TA")[37] defines terrorism as the use or threat of action, designed to influence the government or an international governmental organization or to intimidate the public that is made for the purpose of advancing a political, religious or ideological cause and which involves serious violence against a person or serious damage to property, endangers a person's life or creates a serious risk to the health or safety of the public or is designed to seriously interfere with or seriously disrupt an electronic system[38].

A criminal offense is committed if a person:

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[34] The Money Laundering Regulations 2007, 2007 No. 2157 (Eng.).

[35] Most relevant persons are in the financial services sector, but also included are: bureaux de change; estate agents; casino operators; insolvency practitioners; tax advisers; external accountants; auditors; lawyers; trust and company service providers; dealers in high value goods who trade in goods by way of business where a transaction involves accepting one or more cash payments of or amounting to €15,000 or more; and money service businesses.

[36] Id. Reg 5.

[37] Terrorism Act 2000, 2000 c.11 (Eng.).

[38] Id. §1.

- is invited to provide money or property intended to be used for the purposes of terrorism;[39]

- receives or provides money or property and intends that it should be used for the purposes of terrorism;[40]

- uses or possesses money or property for the purposes of terrorism;[41]

- Enters into financial arrangements which result in monies being used for the purposes of terrorism[42] or conceals the true owner of such monies.[43]

The maximum penalty for offenses under the TA is 14 years imprisonment, an unlimited fine or both.

4. Steps to be Undertaken by a Franchisor

Franchisors operating within the regulated sector[44] - essentially financial services businesses offering banking or insurance - are subject to much stricter controls and must comply with more onerous standards. Fortunately, very few franchisors operate within the regulated sector.

In order to comply with the money laundering legislation, employees must be made aware of the law relating to money laundering and terrorist financing and must be regularly given training in how to recognize and deal with transactions and other activities which may be related to money laundering or terrorist financing[45].

In determining whether an offense has been committed for failing to disclose information relevant to money laundering under POCA and whether there has been a failure to comply with the 2007 Regulations, the court must consider whether the person followed any relevant

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[39] Id. §15(1).

[40] Id. §15(2).

[41] Id. §16(1) & (2).

[42] Id. §17.

[43] Id. §18(1).

[44] A business is in the regulated sector if it engages in any of the following activities (Schedule 9, Part 1(1) POCA): (a) accepting deposits by a person with permission under Part 4 of the Financial Services and Markets Act 2000 to accept deposits; (b) the business of the National Savings Bank; (c) business carried on by a credit union; (d) any home-regulated activity carried on by a European institution in respect of which the establishment conditions in paragraph 13 of Schedule 3 to the Financial Services and Markets Act 2000, or the service conditions in paragraph 14 of that Schedule are satisfied; (e) any activity carried on for the purpose of raising money authorized to be raised under the National Loans Act 1968; (f) the activity of operating a bureau de change, transmitting money (or any representation of monetary value) by any means or cashing checks which are made payable to customers; (g) any activity falling within sub-paragraph (2); (h) any activities in points 1 to 12 or 14 of Annex 1 to the Banking Consolidation Directive; (i) business which consists of effecting or carrying out contracts of long term insurance by a person who has received official authorization pursuant to Article 6 or 27 of the First Life Directive.

[45] Money Laundering Regulations 2007, Reg 21.

guidance issued by a supervisory body or other appropriate body[46] and approved by the United Kingdom's treasury department. It is important, therefore, that franchisors be up-to-date with all general guidance and any guidance that may be issued by bodies relating to their particular industry.[47]

IV. COMPETITION/ANTITRUST LAWS

A. Application of U.S. Antitrust Laws to International Agreements[48]

1. Federal and State Antitrust Statutes

The United States antitrust laws apply to all companies and individuals doing business in the United States, but also to conduct that occurs outside of the United States if the conduct in question has a "direct, substantial and reasonably foreseeable effect" on competition within the United States.[49] Therefore, an agreement between a U.S. franchisor and its foreign franchisee, developer or master franchisee may become subject to U.S. antitrust laws if it has a direct and substantial impact on competition in the United States. Consequently, it is important for U.S. franchisors expanding internationally to have an understanding of what antitrust law issues may arise in setting up and managing relationships with foreign franchisees and how to address such issues.

The principal U.S. federal antitrust laws are the Sherman Act, the Clayton Act and the Robinson-Patman Act. In addition, recently, the Federal Trade Commission (the "FTC") has used Section 5 of the Federal Trade Commission Act (the "FTC Act") in pursuing claims of unfair competition. Finally, the states have also adopted their own antitrust statutes.

The Sherman Act,[50] enacted in 1890, is the oldest and most important of the antitrust statutes. It prohibits every "contract, combination … or conspiracy, in restraint of trade or commerce among the several States or with foreign nations".[51] The foregoing prohibition has been interpreted by the Supreme Court[52] to proscribe only *unreasonable* restraints of trade. In addition, the Sherman Act makes it a felony for anyone to "monopolize or attempt to monopolize," or "conspire … to monopolize".[53] The Sherman Act attempts to prevent the

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[46] An appropriate body is defined as anybody which regulates or is representative of any trade, profession, business or employment carried on by the alleged offender. §330(13) POCA.

[47] The main guidance on anti-money laundering can be obtained from the Joint Money Laundering Steering Group ("JMLSG") (The full text of JMLSG guidance can be found at http://www.jmlsg.org.uk/industry-guidance/article/part-i-part-ii-part -iii-and-treasury-ministal-approval.) The latest JMLSG guidance was published in December 2007 and includes guidance on customer due diligence, monitoring and reporting procedures.

[48] The authors thank Lucie Guyot, an associate with Faegre & Benson LLP, for her contribution to this section.

[49] 15 U.S.C. § 6a.

[50] 15 U.S.C. §§ 1-7.

[51] 15 U.S.C. § 1.

[52] *Standard Oil Co. v. United States*, 221 U.S. 1, 63-66 (1911), cited in Thomas J. Collin and Alicia L. Downey, *Critical Antitrust Issues for Franchisees and Franchisors*, 28th Annual Forum on Franchising (2005) at 8 (hereafter cited as "Collin and Downey").

[53] 15 U.S.C. § 2.

artificial raising of prices by restriction of trade or supply. The Sherman Act protects competition, rather than competitors, unlike, for example, EU law, which tends to protect competitors in the marketplace, sometimes even at the expense of market efficiencies and consumers.

The Clayton Act,[54] adopted in 1914, proscribes certain additional activities that had been discovered to fall outside the scope of the Sherman Act. For example, the Clayton Act forbids any person to "lease or make a sale" of "commodities" contingent upon the lessee or buyer agreeing not to use or deal in the goods of a competitor where the effect of such lease or sale may "substantially lessen competition".[55] The Clayton Act only applies to arrangements governing the lease or sale of "goods" or "other commodities," and does not apply to arrangements regarding services, licenses or other intangible property. In addition, the Clayton Act addresses issues that arise as a result of mergers and acquisitions and it proscribes mergers and acquisitions if the effect of the merger or acquisition "may be substantially to lessen competition".[56]

The Robinson-Patman Act[57] amended the Clayton Act in 1936 and proscribed certain anticompetitive practices in which manufacturers engaged in price discrimination against equally-situated distributors. Contrary to the Sherman Act and the Clayton Act, which are aimed at protecting competition and prohibiting conduct that lessens or eliminates competition by means of "unreasonable" restraints of trade and monopolistic behavior, the Robinson-Patman Act affords protection to individual competitors, which makes it much more controversial.[58]

In addition to the federal antitrust statutes, the states have adopted antitrust laws, which codify state common law prohibitions against anticompetitive restraints.[59] Like their federal counterparts, such laws provide the basis for criminal prosecutions as well as private causes of action for injunctive relief or recovery of multiple damages and attorney's fees. In some states, the state antitrust laws may differ significantly from the federal statutes, especially as it relates to (a) availability of private right of action; (b) applicable statutes of limitations; (c) range of fines imposed as civil or criminal penalties and (d) availability of multiple damages in private actions.[60] Although most states have enacted statutes that prohibit the same types of conduct prescribed by the Sherman and Clayton Acts, there are only a few states that have adopted laws that are counterparts to the Robinson-Patman Act.[61]

Finally, in addition to the state antitrust statutes, the state statutes that provide protection to franchisees also have an important impact on competitive activities of franchisors and franchisees.

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[54] 15 U.S.C. §§ 12-27.

[55] 15 U.S.C. § 14.

[56] 15 U.S.C. §18.

[57] 15 U.S.C. §13.

[58] Collin and Downey at 3.

[59] *Id.* at 4.

[60] *Id.*

[61] *Id.* at 5.

2. **Critical Antitrust Issues Applicable to Franchising**

Restraints of trade that are the subject of antitrust scrutiny are categorized as either vertical or horizontal restraints.[62] As stated above, only "unreasonable" restraints of trade are unlawful under U.S. antitrust laws. Certain restraints have been characterized as "per se illegal", and such restraints are agreements between competitors to fix prices, boycott suppliers, allocate customers or territories or rig bids.[63] All other restraints are subject to evaluation under what is known as the "rule of reason", in which the court takes into account all applicable circumstances.[64]

For purposes of Section 1 of the Sherman Act (Section 2 of the Sherman Act, prohibiting monopolization, has little application to franchising) and Section 3 of the Clayton Act, there must be an "agreement" or "conspiracy", and this requirement has been interpreted to mean a "knowing commitment to or adherence to a course of conduct or plan."[65] Although a principal and its agent cannot conspire for purposes of the antitrust laws, currently there is no consensus that a franchisor and franchisee are considered such a "single" entity for purposes of antitrust laws.[66]

Vertical restraints are analyzed differently depending on whether they are price or non-price restraints. Maximum and minimum price fixing (*i.e.,* a supplier's prohibition against a dealer reselling above or below a certain price) is subject to a rule of reason analysis.[67] Normally, a franchisor's argument that a pricing cap or floor supports inter-brand competition will win over a franchisee's position that it unreasonably restrains intra-brand competition.[68] Franchisors may suggest the prices at which their franchisees sell goods at retail in cooperative advertising funded in whole or part by franchisor.[69] Of course, good practice would dictate that the phrase "at participating locations only" be added so the public is not mislead when a franchisee does not offer those prices. This is especially helpful when the franchisee's unit is in a unique venue with higher costs, such as airports and hotels.

Non-price restraints are also evaluated under the rule of reason.[70] Although case law characterizes tying as a "per se" violation, the analysis involved is so fact-intensive and dependent on economic data that it is, in reality, a "rule of reason" analysis.[71] A plaintiff

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[62] *Id.* at 7.

[63] *Id.*at 8.

[64] *Id.* at 8.

[65] *Id.* at 9.

[66] *Id.* at 10.

[67] *Id.at 10. Also see, Leegin Creative Leather Products, Inc.v. PSKS, Inc.,* 551 U.S. 877 (2007); and Steven B. Feirman and Allan P. Hillman, *Antitrust Issues: Back in Vogue*, American Bar Association, 33rd Annual Forum on Franchising (2010) (hereafter referred to as "Feirman and Hillman").

[68] *Id.*

[69] *Id.* at 12.

[70] *Id.*

[71] *Id.* at 13.

attempting to prove an unlawful tying arrangement must establish that (a) there are two separate products; (b) the sale of one product is conditioned upon the purchase of another product; (c) seller has sufficient economic power in the market for the "tying product" to coerce purchase of the tied product; and (d) a not insubstantial amount of commerce in the market for the tied product is affected.[72] In analyzing tying claims, a requirement that a franchisee purchase products only from approved sources has been identified as a contractual limitation (*i.e.,* the requirement is set forth in the franchise agreement) rather than franchisor's market power.[73]

The grant of territorial exclusivity by a franchisor to a franchisee is presumptively legal because it serves to strengthen inter-brand competition.[74] A franchisor's prohibition on franchisees selling outside of a specified territory will be subject to a rule of reason analysis.[75]

Horizontal price fixing (*i.e.,* agreements to fix the price at which goods will be sold or purchased) is per se illegal.[76] Agreements among competitors to allocate customers, divide territories or otherwise restrict competition for customers are also per se illegal.[77] Thus, any agreement among franchisees to stabilize, peg or fix prices at which they sell goods or services to customers are per se illegal.

Although courts have not addressed this issue, it has been suggested that a difference in franchise fees charged by a franchisor would not be actionable as price discrimination in the "sale" of a commodity and thus would not violate the Robinson-Patman Act.[78]

3. Recent Shift in Washington Toward Greater Antitrust Scrutiny

The Obama administration has announced a more pro-enforcement approach to antitrust compliance.[79] The FTC leadership is now seeking to reinvigorate the use of Section 5 of the FTC Act to pursue "unfair competition" claims that may not technically violate any other laws, whereas in recent years, the FTC usually did not pursue stand-alone Section 5 actions but added Section 5 claims to Sherman Act or Clayton Act claims.[80] The DOJ and the FTC released revisions to their Horizontal Merger Guidelines (these are guidelines for the agencies' reviews of proposed mergers between competitors or potential competitors), which expand the agency's ability to review mergers and acquisitions that previously would not be subject to an antitrust scrutiny.[81]

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[72] *Id.*

[73] *See* Feirman and Hillman at 15.

[74] *Id.* at 18.

[75] *Id.*

[76] *Id.* at 21.

[77] *Id.*

[78] *Id.*

[79] Feirman and Hillman, at 1.

[80] *Id.*

[81] *Id.* at 3.

Since the Supreme Court's 2007 decision in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.,* which overturned case law that had held minimum resale price maintenance agreements per se illegal, many members of Congress, supported by 38 state attorneys general, have attempted to overturn *Leegin* by legislation. Members of Congress are also pushing for vigorous antitrust enforcement.[82]

4. State Antitrust Laws

In addition to the increased efforts by federal regulators to step up antitrust enforcement, state regulators have continued their vigorous antitrust enforcement as well. For example, the state of Maryland has enacted legislation that overturns the *Leegin* decision.[83] In addition, fifteen other states already have had legislation that could be interpreted as rendering resale price maintenance *per se* illegal.[84] Therefore, before assuming that a franchisor can establish minimum resale prices for its goods and services, the franchisor must examine the governing law of the agreement. So, for example, if Maryland law governs the agreement, then Maryland's prohibition on minimum resale price maintenance could make any attempt to establish minimum prices *per se* illegal.

B. EU and UK Rules

1. Articles 101/102 of the TFEU

Within the European Union[85] two sets of competition laws apply, those that are contained in the European Union's own legislation and those of each member state. Sometimes the legislation of a member state mirrors that of the European Union (as is the case within the United Kingdom) but sometimes a different approach is adopted (as is the case with Germany). This section will, therefore, deal with not only European Union competition laws, but also, by way of brief comparison, the competition laws of the United Kingdom.

2. Application

Articles 101 and 102[86] of the Treaty on the Functioning of the European Union ("TFEU") are the primary sources of EU competition law. Article 101 deals with anticompetitive agreements, decisions and concerted practices – and is the article that has the greatest impact on franchising - and Article 102 regulates abuses of a dominant position and which has, so far, not been applied to franchising within the European Union. Article 101 prohibits "*all agreements between undertakings, decisions by associations of undertakings and concerted practices which*

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[82] *Id.* at 3-4.

[83] *Id.* at 4.

[84] *Id. Also see*, Michael A. Lindsay, *An Update on State RPM Laws Since Leegin,* theantitrustsource, www.antitrustsource.com (December 2010).

[85] Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia Slovenia, Spain, Sweden, United Kingdom.

[86] Articles 101 and 102 were initially Articles 85 and 86 of the Treaty of Rome and then subsequently Articles 91 and 92 of the EU Treaty. While the Article numbering has changed, no changes to the drafting of the provisions have been made.

may affect trade between member states and which have as their object or effect the prevention, restriction or distortion of competition within the internal market.[87] The effect of entering into an agreement that violates Article 101(1) is that either the whole agreement or the offending provisions (depending on the seriousness of the breach) will be void and unenforceable. In addition, the parties are liable to substantial fines of 1,000,000 Euros (approximately U.S. $1,600,000) or, if greater, 10% of worldwide sales.

3. Exceptions and Exemptions

In order to avoid having to deal with a large number of notifications of franchise agreements for the purposes of seeking an exemption under Article 101(3), the European Commission initially published a block exemption (a general exemption that applies to a category of agreements) for franchise agreements,[88] which was replaced by a block exemption applying to all vertical agreements, including franchise agreements.[89] Vertical agreements are agreements between entities at a different level of trade, such as franchisors and franchisees, and generally do not give rise to serious competition law issues. The purpose of a block exemption is to set out the conditions under which an agreement will be treated as complying with Article 101(3) and is, therefore, exempted from the prohibitions set out in Article 101(1). In addition to publishing a block exemption, the Commission has published a Notice on Agreements of Minor Importance[90] and a Recommendation in relation to Small and Medium Sized Businesses[91] ("SMEs"). In practice, most franchise agreements within the European Union are entered into by franchisors and franchisees who are SMEs or who have a market share of less than 15% and are therefore unlikely to be regulated by Article 101 in the first place. Nevertheless franchisors generally seek to comply with the vertical agreements block exemption.

Further, an effect on trade between member states is an essential element for bringing Article 101 into play. Many franchisors, especially those with relatively small franchise networks, which operate in only one country within the European Union believe that their agreements are unlikely to have such an effect on trade between member states. This view may not be justified. The European Court indicated in the *Pronuptia*[92] case that franchise agreements are capable of affecting trade between member states "even if they are concluded between enterprises established in the same member state", if they "prevent the franchisees from setting themselves up in another member state".[93] In practice, franchise agreements will not contain an express prohibition on setting up in another member state, but franchises are almost invariably granted for specific areas and franchisees are not allowed to set up their place of business outside their allocated area.

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[87] TFEU Article 101(1).

[88] Comm'n No. 4087/88 [1988], O.J. L359/46, Comm'n Reg. No. 2790/1999 [1999], which was replaced by O.J. L336/21.

[89] Comm'n No. 2790/1999 [1999], which was replaced by O.J. L336/21.

[90] OJ C368, 22.12,2001, at 13-15.

[91] 2003/361/EC.

[92] *Pronuptia de Paris GmbH, Frankfurt am Main v Pronuptia de Paris Irmgard Schillgalis*, Hamburg (Case 161/84) [1986] 1 C.L.M.R. 414 ("*Pronuptia*").

[93] Id. 26.

The block exemption prohibits certain practices and contractual provisions which would ordinarily often be found in franchise relationships as follows:-

4. Vertical Restraints Block Exemption

The Commission has recently published a block exemption[94] (replacing a previous similar block exemption) the purpose of which is to exempt those vertical agreements which do not contain anticompetitive clauses from the Article 101 prohibition. The block exemption only applies if the franchisor and the franchisee have a market share of no more than 30%. The franchisor's market share is calculated on the market in which products and services are sold to consumers. In the case of franchisees, it is calculated on the market in which they purchase products. The block exemption is supplemented by guidelines detailing the Commission's policy concerning aspects of the block exemption. These guidelines have considerable importance for understanding the Commission's approach.

a. Resale Price Maintenance

Article 4(a) regulates minimum price fixing. Maximum and recommended selling prices are permitted provided that they are not a disguised form of minimum price fixing. Care has to be taken to ensure that pressure is not put on franchisees, whatever the franchise agreement provides, to comply with fixed prices. This pressure can take many forms and could include hardships being imposed on franchisees as a result of quoting prices other than those set by the franchisor.

Although franchisors are entitled to require franchisees to participate in promotions, they cannot require franchisees to comply with the franchisor's prices in such promotions. The Guidelines – but not the block exemption itself - contemplate that resale price maintenance can, however, be permitted in the following situations:

- Sales promotion during the introduction of a new brand;
- Short term low price campaign[95];
- to prevent "free riding" by those dealers who do not "provide (additional) pre-sales services, in particular in case of [expensive] or complex products."[96]

b. Exclusive Territories

Article 4(b) prohibits the restriction of the territory into which, or of the customers to whom, a franchisee may sell the contract goods or services.

The restriction applies only to "active sales" into the exclusive territory or to the exclusive customer group reserved to the franchisor or allocated by the franchisor.

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[94] Comm'n Reg. No. 330/2010, O.J. L102, 23.4.2010. See also Comm'n Notice, Guidelines on Vertical Restraints, O.J. C130, 19.05.2010 ("Guidelines"), which can be obtained at http://ec.europa.eu/competition/antitrust/legislation/vertical.html.

[95] Guidelines Id. ¶ 225. Short term generally means two to six weeks.

[96] Id.

Franchisors should, as a result, ensure that all territories which are unallocated are exclusively reserved to the franchisor.

The difference between active and passive selling is fundamental to the Commission's approach. Paragraph 51 of the Guidelines sets out the Commission's view as to what constitutes active sales and passive sales as follows:

> "Active" sales mean actively approaching individual customers by for instance direct mail, including the sending of unsolicited emails or visits; or actively approaching a specific customer group or customers in a specific territory through advertisement in media, on the internet or other promotions specifically targeted at that customer group or targeted at customers in that territory. Advertisement or promotion that is only attractive for the buyer if it (also) reaches a specific group of customers or customers in a specific territory, is considered active selling to that customer group or customers in that territory.
>
> "Passive" sales mean responding to unsolicited requests from individual customers including delivery of goods or services to such customers. General advertising or promotion that reaches customers in other distributors' (exclusive) territories or customer groups but which is a reasonable way to reach customers outside those territories or customer groups, for instance to reach customers in one's own territory, are passive sales. General advertising or promotion is considered a reasonable way to reach such customers if it would be attractive for the buyer to undertake these investments also if they would not reach customers in other distributors' (exclusive) territories or customer groups.[97]

c. <u>Internet</u>

Further, paragraph 53 of the Guidelines[98] makes it clear that the use of the internet to advertise or sell products constitutes passive sales and that a restriction on the use of the internet by franchisees is generally not permitted. The Commission does, however, take the view that "online advertisement specifically addressed to certain customers is a form of active selling to these customers".[99] For instance, territory-based banners on third party websites are a form of active sales into the territory where these banners are shown. In general, efforts to be found specifically in a certain territory or by a certain customer group is active selling into that territory or to that customer group. Also, paying a search engine or online advertisement provider to have an advertisement displayed specifically to users in a particular territory constitutes active selling into that territory.

The Commission regards the following as restrictions on passive selling and, therefore, prohibited as a hard core restriction:

- Automatic re-routing of customers to the franchisor's or other franchisees' website;

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[97] Id. ¶51.

[98] *Id*.

[99] Id. ¶ 53.

- Requiring a franchisee to terminate a consumer transaction once its credit card data reveals an address that is not within the franchisee's exclusive territory;

- Requiring a franchisee to limit the proportion of overall sales made over the internet. However, this does not exclude the franchisor imposing minimum sales requirements on the franchisees' sales from their brick and mortar shops;

- Agreeing a higher price for products sold on the internet.[100]

d. <u>Noncompetition Covenants (including exclusive dealing)</u>

The regulation of in-term and post-term noncompetition covenants is set out in Article 5 of the block exemption which, unlike the "hard core" restrictions in Article 4 which invalidate the whole franchise agreement, gives rise only to the invalidity of the offending clauses and not the whole agreement.

Noncompetition clauses are prohibited by Article 5(1)(a).[101] The Commission's definition of a noncompetition obligation contains two elements. The first is a prohibition, in effect, on being involved in a competing business. The second element is not what most business people would consider to be a non-competition obligation. It is rather an exclusive purchase obligation. If a franchisor obliges a franchisee to purchase more than 80 per cent of a franchisee's total purchases of the contract goods or services from the franchisor and/or its nominated supplier - this would constitute a noncompetition obligation. The percentage is calculated on the basis of value and not on quantity unless standard industry practice calculates sales in volumes.

The above should be read subject to paragraph 190 of the Guidelines,[102] which makes it clear that a noncompetition obligation will fall outside Article 101(1) when the obligation is necessary to maintain the common identity and reputation of the franchised network. This reflects the European Court's judgment in *Pronuptia* in which the Court indicated that a clause requiring franchisees "to sell only those goods originating with the franchisor or the suppliers chosen by the franchisor may be considered necessary to protect for the network's reputation.[103]

Article 5(b) prohibits post termination, noncompetition clauses in the following terms:

> Any direct or indirect obligation causing the buyer, after termination of the agreement, not to manufacture, purchase, sell or resell goods or services ….unless:
>
> (a) the obligation relates to goods or services which compete with the contract goods or services;

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[100] At the date of writing this paper C-439/09, Pierre Fabre Dermo-Cosmétique SAS, has reached the stage of oral hearing before the European Court. It will consider whether restrictions can be imposed on the use of the internet by selective distributors. It is believed that some of the issues will be relevant to franchising.

[101] Comm'n Reg. No. 330/2010, O.J. L102, 23.4.2010, at 5.

[102] Guidelines at 57.

[103] *Pronuptia* ¶ 21.

(b) the obligation is limited to the premises and land from which the buyer has operated during the contract period;

(c) the obligation is indispensable to protect know-how transferred by the supplier to the buyer;

(d) the duration of the obligation is limited to a period of one year after termination of the agreement.

5. UK Legislation

In the United Kingdom, the Competition Act 1998[104] also regulates anti competitive agreements. The Chapter I Prohibition prohibits and regulates agreements and reflects Article 101 of the TFEU. The stated aim of the legislators in enacting the Competition Act was to ensure that UK competition legislation adopted a similar approach to that of the European Union on which many other member states (such as Ireland and France) have based their own competition legislation. Indeed, Section 60 of the Act sets out the principles that must be applied by the United Kingdom authorities and courts when applying the provisions of the Act with a view to ensuring consistency with community law.

The Competition Act prohibits agreements that prevent, restrict or distort competition and may affect trade within the United Kingdom unless they are exempted by Section 9 of the Act. The term “agreement” includes commercial agreements and concerted practices. Further, the term “agreement” includes oral and written agreements, those agreements which are not legally binding such as gentlemen’s agreements and could also include cooperation between businesses that is not evidenced by any agreement or decision.

A violation of the Chapter I Prohibition results in the offending agreement being held void, and the parties to the agreement may be liable to penalties of up to 10 percent of their UK turnover. Further, third parties who have been harmed by such agreements can pursue damages claims in the UK courts.

Section 9 of the Competition Act provides for exemption of agreements that have beneficial aspects. If an agreement complies with the EU’s vertical agreements block exemption it will be exempted under English law.

V. DISCLOSURE

A. Application of U.S. Laws to international agreements

In the United States, disclosure obligations in connection with the offer and sale of a franchise stem from federal disclosure obligations under the FTC Franchise Rule and state-specific franchise legislation. Under the Amended FTC Franchise Rule, the franchise disclosure requirements under the rule apply only to the offer or sale of a franchise to be located within the U.S. or its territories.[105] While not strictly international, U.S. territories such as Puerto Rico or Guam are often treated, from an operations standpoint, like international locations:

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[104] Competition Act, 1998, c. 41 (Eng.), available at www.hmso.gov.uk/acts/acts1998/19980041.htm.

[105] 16 C.F.R. §436.2.

however, unless one of the Amended Rule's exemptions to disclosure applies,[106] franchisors must provide a franchise disclosure document to prospective franchisees in Puerto Rico, Guam and other U.S. territories.

The Amended Rule, however, does not pre-empt state or local franchise laws[107] and, depending on the circumstances, several of the state franchise disclosure laws may require that a franchisor provide pre-sale disclosures in connection with an international franchise agreement.[108] In general, a disclosure obligation under state law may apply if the franchisee is domiciled in the state, if the franchisee is actually present in the state or if an offer is made or accepted in the state.

California, Hawaii, Indiana, Maryland, and Wisconsin require disclosure in connection with an international franchise agreement if the franchisee is domiciled in the state.[109] Minnesota and Rhode Island require disclosure if the franchisee is domiciled in the state or actually present in the state.[110] Illinois, New York, North Dakota, Oregon, South Dakota and Washington require disclosure if the franchisee is domiciled in the state or an offer is made or accepted in the state.[111] The exemptions from disclosure for businesses to be operated or franchisees located outside the state in Minnesota, Maryland, Rhode Island and Wisconsin require that the offer and sale be in compliance with the laws of the foreign jurisdiction.[112]

In limited circumstances, several state business opportunity laws could impose a disclosure requirement for an international franchise sale. For example, the Ohio business opportunity statute exempts a sale that "fully complies" with the FTC Franchise Rule or where the franchisor provides a UFOC (specifically referencing the UFOC adopted in 1977).[113] Although, from a practical standpoint, it seems clear that the intent of the Ohio business opportunity law is to exempt franchises, the statute has not been since the adoption of the Amended Rule and franchisors in Ohio or with an international transaction with a connection to Ohio should assess whether the business opportunity statute requires disclosure. In addition, for franchisors without a federally registered trademark, state business opportunity laws that

[106] 16 C.F.R. §436.8.

[107] 16 C.F.R. §436.10. ("The FTC does not intend to preempt the franchise practices laws of any state or local government, except to the extent of any inconsistency with Part 436. A law is not inconsistent with Part 436 if it affords prospective franchisees equal or greater protection, such as registration of disclosure documents or more extensive disclosures.")

[108] California Franchise Investment Law, Cal. Bus & Prof Code §31105; Haw. Rev Stat §482E.-4; Ind. Code §2; MD. Code Ann. Bus. Reg. 02.02.08.10; Wis. Stat. 32.05(1)(d).

[109] California Franchise Investment Law §31105; Hawaii Franchise Investment Law §482E.-4; Ind. Code §2; Maryland Regulations 02.02.08.10; Wisconsin Regulations 32.05.

[110] Minn. Stat. 80C.03(h); Rhode Island § 19-28.1-7.

[111] 815 Ill. Comp. Stat. 705/10; N.Y. Gen. Bus. Law s 681(12)(a); N.D. Cent. Code s 51-19-02(14)(b)(1); Or. Rev. Stat. 650.015(1); S.D. Codified Laws 37-5A-7.1; Wash. Rev. Code 19.100.020.

[112] Minn. Stat. 80C.03(h); Maryland Regulations 02.02.08.10; Rhode Island 19-28.1-7; Wisconsin Regulations 32.05.

[113] Ohio Rev. Code Ann. 1334.13. For a more complete list of the state business opportunity statutes that may apply, *See* Carl Zwisler, *New Franchise Rule Eases International Franchising*, 26 Franchise Law Journal 163, 167-70 (2007).

exempt franchises with a federally registered trademark could also impose a disclosure requirement.[114]

Although many international transactions will be exempt from disclosure under U.S. law, franchisors need to be aware of the potential disclosure obligations that arise under state franchise and business opportunity laws and should also consider any exemptions to disclosure that may apply in the specific circumstances of an international franchise transaction.

B. Application of Foreign Franchise Laws

1. Foreign Franchise disclosure, registration and relationship laws

Franchise registration, disclosure and relationship laws have been adopted by numerous countries around the world. See the chart attached as Exhibit A for a list of those countries as of July 1, 2011. Although the format of these laws in many cases is similar to the franchise laws adopted in the U.S., there are some notable differences. For example, both Italy and China require the franchisor to have operated units like the ones being franchised prior to granting any franchises to be operated in these countries.[115]

Before entering into any form of agreement, including, in some cases, non-binding letters of intent, the franchisor must determine whether the country where it desires to grant a franchise has laws that affect the franchise agreement. These laws may not even be called franchise laws but may affect the type of relationship created by a franchise agreement. Therefore, it is imperative to consult with local counsel familiar with franchise agreements, before entering into or making an offer to enter into any kind of agreement with a prospective franchisee in another country.

Franchise registration and disclosure laws adopted by other countries are often similar, but not identical, to the requirements of the FTC Rule and state franchise registration laws. Therefore, a U.S. based franchisor cannot simply use its U.S. FDD and add an addendum or wrap-around to comply with the foreign franchise disclosure laws. In some cases, such as Indonesia and Korea, the disclosure document must be translated into the local language. In others, such as Mexico and Brazil, the disclosure document can be in English, if the franchisee demonstrates a sufficient understanding of English so that he or she can comprehend the document. Even where the disclosure document provided to the franchisee can be in English, if the franchise agreement or disclosure document must be registered with the local government, the registered disclosure document or franchise agreement will have to be translated into the local language.

The categories of information required by other countries to be included in a disclosure document are similar to those required by the FTC Rule. A franchisor must be very careful when disclosing information about costs and expenses of opening and operating a unit.

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[114] *See, e.g.,* Conn. Gen. Stat. §36b-61; Carl Zwisler, *New Franchise Rule Eases International Franchising*, 26 Franchise Law Journal 163, 167-70 (2007).

[115] In Italy, the franchisor must have operated a unit in Italy for at least one year prior to granting a franchise (see Article 2 of the Italian Franchise Regulations, CCH Bus. Fran. Guide ¶ 7150). In China, the so-called "2+1" rule requires the franchisor to be able to show that it operated at least two units anywhere in the world for at least one year prior to registering its franchise in China (Regulations on Administration of Commercial Franchise, China, Article 7, CCH Bus. Fran. Guide ¶ 7062).

Normally, those costs and expenses must be specific to the country where the franchisee will operate and will not be the same as the costs in the U.S.

2. General Civil Law Disclosure Obligations

An increasing number of civil law jurisdictions are introducing disclosure obligations. Within Europe these are now contained in statutory requirements in France, Belgium, Italy, Spain and Sweden. These obligations generally impose much less stringent disclosure requirements than would be the case in the U.S. In that sense they come as a "pleasant" surprise to U.S. franchisors. Other jurisdictions, notably Germany and Austria, rely on general civil code obligations in relation to disclosure. These obligations originate from the concept of good faith. In Germany, as a general rule, a franchisor must fully inform a potential franchisee of all circumstances essential for its decision to join the franchise system before the conclusion of the franchise agreement. Inaccurate, incomplete or misleading disclosure gives rise to franchisees frequently claiming that the franchisor has breached its disclosure obligation. The most important issue for franchisors operating in Germany is precisely what disclosure information has to be provided to prospective franchisees.

Where franchisees have established an arguable case that they had been provided with "misinformation", German courts have imposed the burden of proof on the franchisor to show that it has made correct and complete disclosure. At the same time, German jurisprudence established a presumption in favor of the franchisee that incorrect disclosure had led the franchisee to execute the franchise agreement. Franchisors had, therefore, to prove that the franchisee would have entered into the franchise agreement even if correct information had been provided.

This remains the position but stricter requirements are increasingly being imposed on franchisees concerning the evidence they must now provide to substantiate an inadequate disclosure claim.

3. Initial Requirements

Although a number of common law jurisdictions have imposed disclosure requirements, such as the U.S., Australia and Canada, the English approach and the approach of most common law jurisdictions is not to require pre contractual disclosure. In England, franchisors are, in strict legal terms, free to execute a franchise agreement without providing the prospective franchisee with any pre contractual information. Nevertheless, the British Franchise Association ("BFA") Code requires a franchisor to:

- Have operated an outlet with success for a reasonable time in at least one pilot unit before starting its franchise recruitment. Company owned units can provide the basis for a pilot operation but to gain the right experience the pilot should be run by a "manager" on an arm's length basis to test the system and infrastructure. In the case of a master franchisee of a non-UK franchise system a UK outlet is required by the BFA to have been operated prior to participating in BFA sponsored franchise exhibitions;

- Be the owner or have the legal rights to the use of the network's trade name, trademarks or other distinguishing identification.

The BFA Code requires that advertising for franchise recruitment must be free of ambiguity and misleading statements. Further, where there are direct or indirect references to future possible results, figures or earnings to be expected by individual franchisees, such references should be objective, factually based and must not be misleading.

The BFA Code also requires "full and accurate written disclosure of all information material to the franchise relationship within a reasonable time prior to the execution of … binding documents." There are two important points to note. The first is that disclosure requirements are not a legal obligation and what constitutes material information is an inherently vague concept. The BFA in its Guide to the Code of Ethics sets out the types of information that should be provided:

- The business and financial position of the franchisor.
- The people involved in the franchise company.
- The franchise proposition.
- The franchisees.
- The financial projections.

The final point to make is that although the BFA's requirements in its Code of Ethics technically only apply to members of the BFA, the High Court, in a case involving the winding up of a franchisor who was not a member of the BFA,[116] recognized the importance of the BFA's Code of Ethics in assessing the behavior of franchisors generally. Accordingly, there is a significant risk that those franchisors (even those who are not members of the BFA) who fail to operate their franchise business in accordance with the Code of Ethics.

4. <u>Misrepresentation</u>

In addition to the disclosure requirement contained in the Code of Ethics, a requirement which is generally ignored within the United Kingdom, franchisees are given protection by the ability to bring misrepresentation claims against franchisors. It is certainly the custom and practice within the United Kingdom for franchisors to provide franchisees with financial information even where their legal advisors may advise them not to do so. Very often the provision of this information gives rise to a misrepresentation claim even though franchisors inevitably take two precautionary steps:

(1) all financial projections and other information are submitted subject to disclaimers to the effect that the information contained in the information memorandum/projections are not guaranteed by the franchisor, are dependent on the franchisee's performance and should be verified by the franchisee and/or the franchisee's independent financial advisor.

(2) it is customary to insert a provision into the franchise agreement making it clear that the franchise agreement contains the entire agreement between the parties –

[116] *Drivertime Recruitment Ltd: Re DST Limited* [2004] EWHC 1637 (Ch).

so as to limit a franchisee's ability to argue that another document contains a collateral contract – and wording to the effect that no representations have been made.

Within a franchisee's "armory" of claiming a breach of contract or fraudulent misrepresentation, franchisees can also pursue the franchisor for a claim of breach of a duty of care. This duty arises even before the franchise agreement is executed. In the recent case of *Kall Kwik v MGB,*[117] a franchisee argued that when the franchisor provided shop fitting costs to be undertaken by the franchisee once he had acquired the business, the franchisor owed the franchisee a duty of care to ensure that the information provided by the franchisor was accurate.

VI. DATA PROTECTION

A. <u>Application of U.S. Privacy Laws</u>

In contrast to the EU approach to data protection discussed in the following section,[118] the U.S. does not have a comprehensive federal law regulating the use of and collection of data. The U.S. makes use of a combination of a federal and state laws, and regulations that overlap and can even conflict with each other. The U.S. also makes use of a series of guidelines developed by governmental agencies and industry groups that are not legally enforceable but are considered part of best practice and a self regulatory framework.

Notwithstanding the above, 2011 may yield the first comprehensive federal privacy law in the U.S., following a FTC report[119] detailing the inadequacy of self regulation and privacy policies. Several federal bills[120] have been proposed, all of which can be subject to amendments proposed in Congress, the House of Representatives and the Senate.

There are of course many existing federal privacy related laws that regulate the collection and use of personal data. Some of the legislation concerns itself with categories of information, such as health[121] and financial[122] information or electronic communications.[123] Other

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[117] [2010] EWHC 624 (QB).

[118] Other countries follow an approach similar to the EC. For example, in Canada, *see* Privacy Act (R.S.C. 1985, c. P-21) and Personal Information Protection and Electronic Documents Act (S.C. 2000 c. 5); and, in Australia, *see* Privacy Act 1988 (Cth); Telecommunications Act 1997 (Cth); Data-matching Program (Assistance and Tax) Act 1990 (Cth); Crimes Act 1914 (Cth) Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (Cth); Amended the Privacy Act 1988; and Healthcare Identifiers Act 2010 (HI Act) (Cth).

[119] Preliminary FTC Report, *Protecting Consumer Privacy in an Era of Rapid Change, A proposed framework to business and policymakers* , December 2010, available at: http://ftc.gov/os/2010/12/101201privacyreport.pdf

[120] H.R. 654 (Do not Track Me Online Act); H.R. (Best Practice Act); H.R. (Equal Employment for All Act).

[121] Drug and Alcoholism Abuse Confidentiality Statutes, 21 U.S.C. § 1175; 42 U.S.C. § 290dd-3; Genetic Information Nondiscrimination Act, P.L. 110-233, 122 Stat. 881; Health Insurance Portability and Accountability Act of 1996 (HIPAA), 42 U.S.C. § 1306; Employee Retirement Income Security Act, 29 U.S.C. § 1025; and Health Information Technology for Economic and Clinical Health (HITECH Act, Title XIII of Division A and Title IV of Division B of the American Recovery and Reinvestment Act of 2009), Pub. L. No. 111-5;

[122] Electronic Funds Transfer Act, 15 U.S.C. § 1693, 1693m; Fair Credit Reporting Act (1970), 15 U.S.C. § 1681 *et seq.;* Fair Credit Billing Act, 15 U.S.C. § 1666; Consumer Financial Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (Part of Dodd-Frank and not yet codified); Right to Financial Privacy Act (1978), 12 U.S.C. § 3401 *et seq.;* Taxpayer Browsing Protection Act (1997), 26 U.S.C. §§ 7213, 7213A and 7431;Gramm-Leach-Bliley Act (1999), 15 U.S.C. §§ 6801-6809; Fair and Accurate Credit Transactions Act (2003), Pub. L. 108-159 (amendments to the Fair Credit Reporting Act, 15 U.S.C. § 1681 *et seq.*); and Equal Credit Opportunity Act, 15 U.S.C. § 1691 *et seq.*

laws affect particular activities that make use of the personal information, such as collection of information from minors,[124] telemarketing,[125] e-mail,[126] employment records,[127] privacy of government-held data and privacy from government data collection,[128] and privacy of miscellaneous records and activities.[129] The application of U.S. privacy laws for agreements performed outside the U.S. depends upon the scope of each statute and whether they affect information that can be collected by franchisors in the U.S.

B. Application of EU Data Protection Laws

1. The EU approach

The EU approach and data protection rules are set out in the 1995 Data Protection Directive 95/46/EC ("the Directive"). These rules aim to protect the fundamental rights and freedoms of natural persons, and in particular the right to data protection, as well as the free flow of data. The Directive has been complemented by further legal instruments relating to the communications sector[130] and the protection of personal data in police and judicial cooperation matters.[131] The right to the protection of personal data is also specifically recognized in the

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[123] The Electronic Communications Privacy Act (1986), 18 U.S.C. § 2510-22; The Communications Act of 1934, 47 U.S.C. § 151 et seq.; Counterfeit Access Device and Computer Fraud Abuse Act of 1984, 18 U.S.C. § 1030; Telecommunications Act of 1996, 47 U.S.C. § 222 (Amending the Communications Act of 1934); Title III of the Omnibus Crime Control and Safe Streets Act of 1968 (Wiretap Act), 18 U.S.C. §§ 2510-2522; Communications Assistance for Law Enforcement Act of 1994, 47 U.S.C. §§ 1001-1010; Wireless Communication and Public Safety Act (1999), Pub. L. No. 106–81 (Amending the Communications Act of 1934); Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act), Pub. L. No. 107-56; Intelligence Reform and Terrorism Prevention Act of 2004 (IRTPA), Pub. L. 108-458; Implementing Recommendations of the 9/11 Commission Act of 2007 (9/11 Commission Act), Pub. L. 110-53; Foreign Intelligence Surveillance Act of 1978 (FISA), 50 U.S.C. §§ 1801-11, 1821-29, 1841-46, 1861-62, 1871; and The National Security Act of 1947, 50 U.S.C. § 401 et seq.

[124] Children's Online Privacy Protection Act (COPPA) of 1998, 15 U.S.C. §§ 6501–6506.

[125] Telephone Consumer Protection Act of 1991, 47 U.S.C. 227; Do-Not-Call Implementation Act of 2003, 15 U.S.C. § 6101 *et seq.;* and Do-Not-Call Improvement Act of 2007, Pub. L. No. 110-187, amending the DNCI Act of 2003.

[126] Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003 (CAN-SPAM Act), 15 U.S.C. 7701 et seq.

[127] Employee Polygraph Protection Act, 29 U.S.C. § 2001 *et seq.;* and Equal Employment Opportunity Act, 42 U.S.C. § 2000e *et seq.*

[128] Census Confidentiality Statute of 1954, 13 U.S.C. § 9; Computer Security Act, 40 U.S.C. § 1441; Criminal Justice Information Systems, 42 U.S.C. § 3789g; Driver's Privacy Protection Act of 1994, 18 U.S.C. § 2721; Freedom of Information Act (1966), 5 U.S.C. § 552; Privacy Act of 1974, 5 U.S.C. § 552a; Privacy Protection Act of 1980, 42 U.S.C. § 2000aa *et seq.* (media source protection); and E-government Act of 2002, 44 U.S.C. § 101 *et seq.*

[129] Administrative Procedure Act, 5 U.S.C. §§ 551, 554-558; Family Education Rights and Privacy Act of 1974, 20 U.S.C. § 1232g; Cable Communications Policy Act of 1984 and Cable TV Privacy Act of 1984: both at 47 U.S.C. § 551; and, Video Privacy Protection Act of 1988, 18 U.S.C. § 2710. For a more detailed discuss of U.S. privacy laws, *see* M. Fuchs, R. Plesser & M. Power, *Privacy: U.S. and International*, American Bar Association, 25th Annual Forum on Franchising (2002); and P. Jones & D. Koch, *Privacy Issues Affecting Franchising*, American Bar Association, 27th Annual Forum on Franchising (2004).

[130] E-Privacy Directive, 2002/58/EC.

[131] Council Framework Decision, 2008/977/JHA

European Union's Charter of Fundamental Rights of the European Union (Article 8) and the Lisbon Treaty.

The Directive's governing principle is the protection of personal data. Its purpose is not the protection of privacy as such. The Directive's primary objective was to harmonize existing regulations to safeguard the data subject's right to informational privacy and to create a common European market for the free movement of personal data.[132]

The implementation of the Directive is delegated to each individual Member State. This inevitably results in some variation as to its implementation as between Member States.

2. EU regulatory powers

In the United Kingdom the Information Commissioner's Office ("ICO") is the national regulator enforcing the Directive. The ICO has a range of enforcement options under the Data Protection Act 1998 ("DPA") including:

- demanding the disclosure of information to enable the ICO to investigate a case of alleged or suspected failures to comply;
- undertaking an audit of the data controller's premises and facilities to check compliance;
- requiring remedial steps to be undertaken; and
- obtaining orders prevailing engagement in further infringing acts.

In the event that the ICO can demonstrate that there has been a breach of the DPA, it can impose financial penalties of up to £500,000 per breach, if satisfied that there has been a serious contravention of the data protection principles. The ICO also has the power to initiate criminal proceedings against data controllers who commit an offense under the DPA. For example, failing to comply with an enforcement notice would allow the ICO to initiate a proceeding.

The DPA also entitles an individual to bring civil proceedings against a data controller to claim damages.

3. EU/U.S. cooperation

Article 25 of the Directive addresses the transfer of personal data to countries who are not Member States. The Member State is required to provide that the transfer to a third country (a country not in the EU) of personal data which is undergoing processing or is intended to be processed after transfer may take place only if, having complied with the national provisions, the third country ensures an adequate level of protection. Those countries currently listed as having sufficient levels of protection are: Andorra, Argentina, Australia, Canada, the Faroe Islands, Guernsey, the Isle of Man, Israel, Jersey and Switzerland.[133]

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[132] N. Robinson.; H. Graux, M. Botterman & L. Valeri; *Review of the European Data Protection Directive, (*2009).

[133] http://ec.europa.eu/justice/policies/privacy/thridcountries/index_en.htm

Companies operating between the U.S. and EU may engage in cross border transfers of data between Europe and the U.S. in compliance with the Directive by having certification under the Safe Harbor program, using European Commission approved model contracts, or for multinationals, implementing Binding Corporate Rules. The Safe Harbor program was created by the Commission and the U.S. Department of Commerce to address the Commission's view that the U.S. does not have in place a regulatory framework sufficient adequately to protect personal data being transferred from the European Economic Area. If an organization in the U.S. is subject to the jurisdiction of the FTC, or in the case of some transportation organizations subject to the jurisdiction of the U.S. Department of Transportation, then it can participate in the Safe Harbor program. A list of the current participants to the Safe Harbor program may be found on the U.S. Department of Commerce website[134].

The Safe Harbor program requires a voluntary adherence to a set of seven principles: notice, choice, transfers to third parties, access, security, data integrity, enforcement. The Commission has recognized these principles as providing adequate protection and therefore meeting these principles will allow compliance with the Commission's requirements. The organization is required to join a self-regulatory privacy program that adheres to the U.S.-EU Safe Harbor Framework's requirements, or develop its own self-regulatory privacy policy that conforms to the U.S.-EU Safe Harbor Framework. The participating company is required to implement a privacy policy which complies with these principles and to renew its self-certification annually. The organization must in general provide: (1) notice of its privacy policy; (2) a choice to individuals in relation to the use of personal information; (3) access to the information; and (4) protection of the data.

Alternatively, standard contractual clauses (model contracts) can be used to regulate the transfer of personal data from the EU.[135] The contractual clauses aim to establish adequate safeguards by imposing obligations similar to those set out in the Safe Harbor program, and incorporate the Directive's principles. U.S. multinationals also have the option to develop a set of binding corporate rules to regulate data protection and apply to all intra-group transfers of personal data outside of the EU.[136] The binding corporate rules must be approved separately in each EU Member State where the multinational has an office, and the applicant must describe the data protection audit plan, the processing and flows of information, the data protection, safeguards, and mechanisms for reporting and recording changes. Moreover, the multinational company is required to demonstrate that these rules are binding both internally and externally.

4. Proposals to reform EU data protection laws

Since the implementation of the Directive, there have been leaps forward in the globalization process and as a result the Commission has undertaken a wide public consultation which is ongoing.

The results of the latest consultation are due to be delivered later this year. It is then likely that the Commission will propose new legislation.

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[134] https://safeharbor.export.gov/list.aspx

[135] Official Journal of the European Union, L 39/10, 12 February 2010; and L385/77 29 December 2004.

[136] *E.g*. Working Party document WP 108, *Working Document Establishing a model checklist for approval of Binding Corporate Rules,* 14 April 2005; http://ec.europa.eu/justice_home/fsj/privacy/docs/wp108_en.pdf

VII. TERMINATION

A. Application of U.S. State Relationship Laws

Like the laws adopted in many states, foreign countries have specific laws that affect the franchise relationship and others have laws that are not designated as franchise laws, but can affect a franchise agreement. An example of the former is the Korean Franchise Law, which includes a dispute resolution procedure that franchisors and franchisees must include in their agreements. An example of the latter is the agency laws that exist in many Middle East countries which, if applicable, require compensation to a terminated franchisee.[137]

Whether a state's relationship law will apply to an agreement to be performed in another country will depend upon the application of conflicts of laws principles and whether the laws of the other country will permit U.S. or another country's laws to apply to interpret the agreement.[138] For example, the Indonesian franchise law[139] mandates that Indonesian law apply to govern the agreement. When seeking to enforce an agreement against a party in Indonesia, this provision would override the application of U.S. and state laws. If, however, the country where the agreement is being performed will permit U.S. law to apply to interpret the agreement then the applicable state law provision must be examined to determine if it applies to agreements performed outside the state.[140] The California Franchise Relations Act specifically states that it applies "to any franchise where either the franchisee is domiciled in this state or the franchised business is or has been operated in this state."[141] Therefore, even if the franchisor and franchisee agreed that California law was the governing law of the agreement, the Franchise Relations Act would not be applicable to the parties' agreement.

B. Application of EU and UK Laws

Council Directive of 18 December 1986 in respect of self employed commercial agencies ("the EU Directive") sets out the mandatory rules that apply on termination of an agency under which the agent - a self employed intermediary who has continuing authority to negotiate the sale or purchase of goods on behalf of another person - is entitled either to be indemnified or to compensation.

Where the agent is entitled to compensation, the rule is that the agent is entitled to compensation for the damage it suffers as a result of the termination of its relations with its principal. The rules do not go on to say what is meant by damage and how compensation is to be calculated.

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[137] *See* discussion of Agency laws at VII.D.

[138] *See* Richard M. Asbill and Steven M. Goldman (editors), *Fundamentals of International Franchising,* American Bar Association Forum on Franchising (2001) (hereinafter *International Franchising*), at 219.

[139] Regulations – The Provisions on and Procedure for the Implementation of Franchised Business Registration, Chapter 2, Article 2(s). *See*, CCH Bus. Fran. Guide ¶ 7140

[140] *See*, James Goniea and Jeffrey Haff, *Termination, Nonrenewal and Transfer*, THE FRANCHISE LAW COMPLIANCE MANUAL (2nd ed. Jeffrey A. Brimer, editor), American Bar Association (2011).

[141] Cal. Bus. & Prof. Code, §20015.

Where the agent is entitled to be indemnified, the entitlement to an indemnity applies if the agent has brought in new customers or significantly increased the volume of business with existing customers and the principal continues to derive substantial benefits from business with such customers. The amount of the indemnity is whatever is equitable considering all the circumstances and, in particular, the commission lost by the agent on the business transacted with those customers. However, the indemnity is not to exceed one year's average annual remuneration calculated over the last 5 years of the contract (or over the whole contract if it is of less than 5 years' duration).

These rules apply throughout the European Union. Some civil law jurisdictions have "by analogy" applied the right of agents to compensation or an indemnity, so as to give franchisees a similar right.

C. Application of Individual EU Countries' Commercial Agency Laws

The application of goodwill indemnities to franchise agreements within the European Union is common in Germany and Austria and may well be available in other civil law jurisdictions such as Portugal, Spain and Holland, but even in Germany there are limits on a franchisee's ability to claim this goodwill indemnity.

In Germany Section 89b of the Commercial Code (compensation claim of a commercial agent after ending of the contract) contains the compensation obligations and the Courts have applied this section "by analogy" to franchise agreements.

The first condition for the application of such an analogy is the integration of the franchisee into the sales organization of the franchisor in a manner similar to that of a commercial agent. The second condition for the analogous application of the compensation claim is that there is a contractual obligation to transfer the customer base. The lack of a contractual obligation is fatal to a franchisee's claim – even if, in practice, the great majority of customers were, in fact, taken over by the franchisor.

D. Middle East

Although the focus of this paper is primarily U.S., U.K. and E.U. law, a discussion of agency laws in the Middle East is relevant because their impact on termination of a franchise agreement.[142]

In the U.S., a franchise relationship is not considered an agency relationship. However, so called commercial agency laws commonly apply to franchise relationships outside of the U.S., particularly if the franchisee will be located in a Middle Eastern country.[143] If agency laws apply to a franchise relationship, the franchisee will often be granted additional rights and may be entitled to compensation upon termination of the relationship.

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[142] Portions of this section were excerpted from Robert A. Lauer and Alison C. McElroy, *International Franchising*, THE FRANCHISE LAW COMPLIANCE MANUAL (2nd ed., J. Brimer, editor), American Bar Association (2011) (hereinafter, "International Franchising").

[143] Joyce Mazero and J. Perry Maisonneuve, *Franchising in the Middle East and North Africa: Legal Perspective*, 32nd Annual Forum on Franchising, American Bar Association (2009).

1. Mandatory Filings and Coverage

If agency laws apply to a franchise agreement, a local court – and in some instances, a court devoted exclusively to agency matters – will assume jurisdiction and apply the country's local law instead of permitting the governing law and venue provisions in the franchise agreement to control.[144] Many countries with agency laws require a copy of an agency (*i.e.,* franchise) agreement to be filed with the government to be categorized as an agency agreement.[145]

For example, in Saudi Arabia, franchise agreements are deemed commercial agency relationships. Commercial agency relationships are governed by Royal Decrees and their implementing rules (collectively, the "Commercial Agencies Regulation").[146] Only Saudi nationals and entities wholly owned by Saudi nationals may be commercial agents. By its terms, the Commercial Agencies Regulation requires the registration of all commercial agencies, and the underlying agency agreements, with the Saudi Arabian Ministry of Commerce & Industry (the "Ministry").

2. Avoiding Filings and Coverage.

Most U.S. franchisors wish to avoid the application of foreign agency laws to the franchise agreement and relationship, primarily because of the inability to terminate effectively a franchise agreement if agency laws apply. In many of these countries, however, there are no express penalties imposed on a foreign principal for failure to register or file an agreement, and the countries also fail regularly to impose penalties on local agents for failure to register. Many U.S. franchisors include in their franchise agreements with franchisees in countries that have agency laws a requirement that the franchisee not register or file the agreement with government authorities. In addition to an outright prohibition on registering the franchise agreement or refusing to cooperate with any efforts a franchisee makes to register the agreement (normally by refusing to notarize or legalize any franchisor signatures on agreements, side letters or other correspondence reflecting the franchise relationship or grant of rights), there are other ways for a U.S. franchisor to protect itself from the application of commercial agency laws to the franchise relationship. A franchisor may use a letter of credit or bank guaranty or seek to impose liquidated damages in the amount the franchisor expects would be imposed if an agency law were to apply to the termination of the agreement. If a development agreement is in place, the franchisor may make the registration or filing of a franchise agreement as an agency agreement an event of default that results in termination of the development agreement and other franchise agreements.

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[144] *Id.*

[145] *See* International Franchising.

[146] Royal Decree No. 11, dated 20/2/1381AH, as amended by Royal Decree No. 5, dated 11/6/1389AH and Royal Decree No. 32, dated 10/8/1400AH and its implementing rules issued by Ministerial Resolution No. 1897 of 24-5-1401AH, which was formally applied to franchise relationships by Ministerial Resolution No. 1012 on Applicability of Commercial Agencies Regulations to Franchising Agreements.

VIII. GOOD FAITH

A. Application of State Relationship Laws

In the U.S., the concept of "good faith" in contractual relationships between parties is applicable in two contexts – the "implied covenant of good faith and fair dealing", which is usually deemed to be part of every contract; and, legislatively mandated good faith, as embodied in state franchise relationship laws.[147]

The implied covenant of good faith and fair dealing generally applies where one party is vested with discretion in performing a particular right or obligation under the contract. The doctrine operates to prevent that party from exercising its discretion in bad faith, arbitrarily, or for an improper purpose so as not to defeat the other party's reasonable expectations under the contract.[148]

The doctrine of good faith and fair dealing has been applied to a broad array of franchisor conduct (such as encroachment, advertising, and provision of franchise support services), and the law in this area is constantly evolving. As a general rule, however, the implied covenant cannot override or negate express contractual terms, so courts generally give full effect to the parties' contractual provisions.[149] Further, certain courts have held that good cause for termination will defeat a claim for breach of the implied covenant based on the franchisor's allegedly improper motive in taking the challenged action.[150]

State relationship laws, however, can override specific contract terms and will apply to evaluate a party's performance of its contractual obligations. For example, under the Arkansas

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[147] *See* James Goniea and Jeffrey Haff, *Termination, Nonrenewal and Transfer*, THE FRANCHISE LAW COMPLIANCE MANUAL (2[nd] ed., J. Brimer, editor), American Bar Association (2011). Portions of this section were excerpted from this purlbication.

[148] *See, e.g., Taylor Equip., Inc., v. John Deere Co.*, 98 F.3d 1028, Bus. Franchise Guide (CCH) ¶ 11,045 (8th Cir. 1996); *Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies*, 970 F.2d 273, Bus. Franchise Guide (CCH) ¶ 10,042 (7th Cir. 1992); *Dayan v. McDonald's Corp.*, 466 N.E. 2d 958, Bus. Franchise Guide (CCH) ¶ 8223 (Ill. App. Ct. 1984); *Carvel Corp. v. Diversified Mgmt. Group,* Inc., 930 F.2d 228, Bus. Franchise Guide (CCH) ¶ 9,794 (2d Cir. 1991); *Juliano v. Sunoco, Inc.*, 166 F.3d 1205, Bus. Franchise Guide (CCH) ¶ 11,562 (3d Cir. 1998); *Traumann v. Southland Corp.*, 842 F.Supp. 386 (N.D. Cal. 1993); *7-Eleven, Inc. v. McEvoy*, 300 F.Supp.2d 352 (D. Md. 2004); *Town & Country Equip., Inc. v. Deere & Co.*, 133 F.Supp.2d 665, Bus. Franchise Guide (CCH) ¶ 11,958 (W.D. Tenn. 2000); *Mercedes-Benz USA LLC v. Concours Motors, Inc.*, No. 07-C-0389, 2010 WL 55473 (E.D. Wis. Jan. 4, 2010); *Anchorage Chrysler Ctr., Inc. v. DaimlerChrysler Motors Corp.*, 221 P.3d 977 (Ala. 2009); *Cromeens, Holloman, Sibert, Inc. v. AB Volvo*, 349 F.3d 376 (7th Cir. 2003).

[149] *See, e.g., Davis v. Sears, Roebuck & Co.*, 873 F.2d 888, Bus. Franchise Guide (CCH) ¶ 9384 (6th Cir. 1989) (implied covenant held not to override language in contract allowing either party to terminate upon specified notice); Gra*nd Light & Supply Co. v. Honeywell, Inc.*, 771 F.2d 672 (2d Cir. 1985) (same); *Applied Tech., Inc. v. U.S. JVC Corp.*, 61 F.3d 915, Bus. Franchise Guide (CCH) ¶ 10,733 (10th Cir. 1995) (duty of good faith and fair dealing would not modify or negate express right to terminate contract without cause); *Taylor Equip., Inc. v. John Deere Co.*, 98 F.3d 1028, Bus. Franchise Guide (CCH) ¶ 11,045 (8th Cir. 1996); *McDonald's Corp. v. Barnes*, Bus. Franchise Guide (CCH) ¶ 9,807 (D. Alaska 1991); *Chang v. McDonald's Corp.*, Bus. Franchise Guide (CCH) ¶ 10,677 (N.D. Cal. 1995); *Sons of Thunder, Inc. v. Borden, Inc*., 690 A.2d 575 (N.J. 1997); *Cromeens, Holloman, Sibert, Inc. v. AB Volvo*, 349 F.3d 376 (7th Cir. 2003).

[150] *See Robertson v. McDonald's Corp.*, 147 F.3d 1301, 1309 (11th Cir. 1998); *In re Sizzler Restaurants Int'l.*, 225 B.R. 466, Bus. Franchise Guide (CCH) ¶ 11,408 (Bankr. C.D. Cal. 1998); *Haynes Trane Serv. Agency, Inc. v. Am. Standard, Inc*., 51 Fed.Appx. 786 (10th Cir. 2002) (there is no breach of the implied covenant of good faith and fair dealing when termination occurred in accordance with the contract).

Franchise Practices Act,[151] a franchise may only be terminated or not renewed if a franchisor has "good cause", which is defined to include the failure of the franchisee to act in good faith and a commercially reasonable manner.

The application of a "good faith" requirement is important in determining the choice of law that applies to an agreement to be performed outside the U.S. Although, as discussed above, a state's franchise registration or disclosure law may not apply to such agreements, its relationship law could have application.

B. EU and UK Laws

1. Civil Law Approach – What Does Good Faith Mean in Practice?

In all civil law jurisdictions the civil code requires the parties to a commercial agreement to act in good faith. Sometimes, as in Germany, that requirement imposes disclosure obligations on the parties. In other jurisdictions, such as in Brazil, Article 422 of the Brazilian Civil Code imposes an obligation of good faith and that good faith obligation has been interpreted to mean that the parties must proceed with fairness and mutual trust when establishing and executing contractual provisions and Article 422 has been used to strike down provisions which may, in other jurisdictions, be regulated by competition law.

2. Common Law Approach

In terms of the judicial approach in common law jurisdictions, there is an often quoted distinction between the common law approach, which is to deny the concept of good faith in commercial contracts, unless introduced by statute, and the civil law approach, which is to make good faith a fundamental part of the courts' analysis of contractual obligations. There is an apparently irreconcilable difference and yet many senior English judges have consistently proclaimed that although there is no concept of good faith in the common law, they do try to do what is right by other means and have applied legal principles that achieve a similar result. A recent English example, in a franchising context, is the introduction of the property law principle of "derogation from grant". This is a principle that originated from *Harmer v. Jumbil (Nigeria) Tin Areas Ltd.*[152] In that case, a landlord in Nigeria owned two plots of land. He sold the first plot to a developer of luxury flats and then sought to sell the second plot, which was adjoining, to build an ammunitions factory. Not surprisingly, the developer of the luxury flats objected and the courts held that the landlord should not be allowed to do this because effectively he had granted a right to the developer to build luxury flats that the developer simply would not able to do if there was an ammunition factory next door.

This concept was applied in the recent Court of Appeal case of *Fleet Mobile Tyres,*[153] in which a franchisor had started his franchise business granting franchisees exclusive territories in which they would operate trucks from which they would change tires on customers' vehicles. Franchisees obtained their own customers. The franchisor soon discovered the power of the internet and sought to change the basic approach of the franchise so that customer enquiries

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[151] Ark. Code Ann. §§4-72-201 to 4-72-210 (1987) (CCH Bus. Fran. Guide ¶ 4040)

[152] [1921] Ch 200.

[153] *Fleet Mobile Tyres Limited v Stone and Anor* [2006] EWHC 1947 (Qb)

were received not by franchisees but by the franchisor on its web site and then passed on to franchisees after the franchisor had deducted a payment to cover the franchisor's administrative expenses. One franchisee objected to this and said that this was a fundamental change to what he had bought. The Court of Appeal agreed, observing that the principal of derogation from grant embodies in a legal maxim a rule of common honesty which is imposed in the interest of fair dealing.[154] No doubt a similar decision using the concept of good faith would be achieved by the civil law courts.

IX. OTHER REGULATORY ISSUES

A. U.S. Regulatory Issues

1. Export Controls and Licenses

The U.S. Department of Commerce Bureau of Industry and Security ("BIS") is responsible for the enforcement of the federal Export Administration Regulations ("EAR") that regulate the export of commercial items. Although many exports will not require a license, franchisors operating internationally should be aware of potential licensing requirements and that a wide range of commercial items are subject to the EAR.[155] The EAR and other agencies' regulations regulate not only particular commercial items that are exported, but also the exportation of items to particular countries. Franchisors should be aware that export controls will apply based upon the classification of the particular items in question and the countries in which the franchisor intends to ship the items. Although unlikely to impact most franchisors, who will receive the items and the intended use of the items will impact whether an item may be exported and whether a license from the BIS or another federal agency is necessary.

2. Visas and Immigration Control

Although the primary focus of this paper is U.S.-based franchisors doing business in other countries and, therefore, most of the issues involve representatives of the franchisors spending considerable amounts of time in other countries,[156] for training and other purposes, representatives of foreign developers and master franchisees may also spend a considerable amount of time in the U.S. Franchisors are often called upon to assist their foreign developers and master franchisees in obtaining visas and other government permissions.[157]

Most Canadian citizens and many citizens from Visa Waiver Program ("VWP"), countries can come to the U.S. without a visa if they meet certain requirements. All VWP travelers must present a machine-readable passport at the U.S. port of entry to enter the U.S. without a visa; otherwise a U.S. visa is required. Other foreign citizens will need a nonimmigrant visa. The VWP enables nationals of 36 participating countries listed in Exhibit B to travel to the United States for tourism or business (visitor [B] visa purposes only) for stays of 90 days or less without

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[154] Id. ¶ 53.

[155] *See Introduction to Commerce Department Export Controls*, available at http://www.bis.doc.gov/licensing/exportingbasics.htm. Some exports may be controlled by other U.S. Government agencies.

[156] *See* discussion at Section I.A.2.

[157] *See* http://travel.state.gov/visa/ and http://travel.state.gov/visa/temp/temp_1305.html for more information on foreign citizens entering the U.S.

obtaining a visa. The program was established to eliminate unnecessary barriers to travel, stimulate the tourism industry, and permit the Department of State to focus consular resources in other areas. VWP eligible travelers may apply for a visa if they prefer to do so. Nationals of VWP countries must meet eligibility requirements to travel without a visa on VWP, and therefore, some travelers from VWP countries are not eligible to use the program. VWP travelers are required to have a valid authorization through the Electronic System for Travel Authorization (ESTA) prior to travel, are screened at the port of entry into the United States, and are enrolled in the Department of Homeland Security's U.S.-VISIT program.[158]

Nonimmigrant visas are for international travelers (citizens of other countries), coming to the U.S. temporarily. The visa allows foreign citizens to travel to a U.S. port-of-entry and request permission of the Department of Homeland Security (DHS), Customs and Border Protection immigration officer to enter the U.S. A visa does not guarantee entry into the U.S. The type of visa needed is defined by immigration law, and relates to the principal purpose of the person's travel. For an overview of the types of nonimmigrant visas available under immigration law, see Exhibit C. The Consular Officer at the U.S. embassy or consulate will decide what kind of visa is needed when the person applies.

B. EU/Regulatory Issues

1. Customs and Duties on Imported Products

The customs union is at the heart of the EU. It abolished duties at internal borders and created a uniform system for taxing imports. Internal border controls subsequently disappeared.

Within the EU most goods are in free circulation, whether made within the EU or imported from outside. Goods can be moved from one EU country to another without payment of any duty and without any customs control – a key component of the single market. Article 30 TFEU expressly prohibits member states from levying any duties on goods crossing borders within the EU. This applies both to goods produced within the EU as well as those produced outside the EU but which have legally entered the EU market with the appropriate duty having been paid.

The Mutual Recognition Regulation (EC 764/2008) ("Regulation"), which came into force in May 2009, regulates the operation of free trade in goods in the EU and some European Economic Area countries such as Iceland, Norway and Liechtenstein. The customs administrators of all participating countries apply uniform customs policy and a common set of legal rules known as the Community Customs Code.

The Regulation requires all participating countries to provide information on their national technical rules and sets out a standard procedure for enforcing those rules. Technical rules typically relate to weight, size, composition, labeling and packaging. The underlying principle is that goods which are legally sold in one country party to the Regulation can be sold in all other participating countries without having to meet any further requirements to ensure that movement of goods is indeed free and free not only of customs duties but also of any charges that have equivalent effect to customs duties.[159] This principle is not applicable in only very limited

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[158] For more information on the Visa Waiver Program, *see* http://travel.state.gov/visa/temp/without/without_1990.html.

[159] TFEU Article 30.

circumstances, generally only where public health, the environment or consumer safety would be at risk,[160] but even in those cases the measures taken have to be proportionate to the risk.

Article 110 of the TFEU prohibits the imposition of any internal taxation which is not applied in the same way and manner to similar domestic goods. Likewise, quotas and "measures having equivalent effect" are also prohibited[161]. Although the TFEU itself does not provide guidance on what measures constitute "measures having equivalent effect", the European Court of Justice has over several decades developed detailed case law on this issue.[162]

Duty and customs controls apply only when a product from outside the EU first enters the EU; this is regulated by the Common Customs Tariff, which applies to all imported goods across the external borders of the EU. A franchisor which is importing goods from outside the EU will be expected to make an import declaration to customs and pay import duty and import Value Added Tax ("VAT").

All imports from outside the EU must be declared to the customs authorities of the country when the goods first enter the EU. In the UK that authority is HM Revenue & Customs ("HMRC"), a UK Customs authority accountable for, amongst other things, the collection and enforcement of taxes including import VAT.

Declaration to the HMRC can be done using the Single Administrative Document ("SAD"), which uses commodity codes which predetermine the rate of import duty. This document, in the same format, is used throughout the EU. Since 1 January 2011, when new safety and security laws[163] were introduced, all goods must be declared to the Office of First Entry to the EU, i.e. that member state's Import Control System ("ICS"), within set time limits. The legal onus is on the carrier of the goods to make the ICS declaration, although this may be delegated to the importer himself.

Some goods coming into the UK require an import license. Whether a license is required will depend on the type of goods and where the goods are coming from. Goods from European Union countries can generally be brought into the UK with minimal paperwork. When importing from outside the EU, an invoice, a copy of the transport documentation such as the Bill of Lading will be required for customs clearance. In addition, for goods worth over £6,500, a valuation statement will be required.

Imports may be liable to import duty, depending on their classification and origin. Certain goods from some countries attract either a reduced or zero rate of import duty although there may be a limited annual quota of which a franchisor would need to be aware. To claim a reduced or zero rate duty, a franchisor would need to produce documentary proof of origin which clearly shows where the goods were manufactured or produced.

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[160] TFEU Article 36.

[161] TFEU Article 34.

[162] Judgment of the Court of Justice, Dassonville, Case 8/74 (11 July 1974); Judgment of the Court of Justice, Rewe_Zentral, Case 120/78 (20 February 1979); Judgment of the Court of Justice, Keck and Mithouard, Joined cases C_267/91 and C_268/91 (24 November 1993).

[163] Regulation (EC) 648/2005.

Imported goods from outside the EU attract VAT at the same rate as UK goods. VAT is also payable on any import duty. Import VAT is payable directly to HMRC. Most franchisors are likely to be VAT registered, and in most systems franchisees are also required to be VAT registered, which means that a franchisor can reclaim VAT in the same way as for goods purchased in the UK. It may also be possible to delay the liability on import duty and/or VAT if the goods are not required for use immediately. Import duty, excise duty and VAT must, however, be paid before the goods can be put into free circulation.

2. Visas and Immigration Control

Citizens of the European countries can travel freely within the EU free of immigration controls and without a need to obtain visas. For stays of less than three months the only requirement on the citizens of the EU countries is that they possess a valid identification document. The rights of residence for longer than three months remain subject to certain conditions, with the main ones relating to involvement in an economic activity, whether on an employed or self-employed basis, and having sufficient resources so as not to be a burden on the social services of the host member state.

Some of the European states[164] have signed the Schengen Agreement opening their borders to persons from outside the EU, which means that once a person has legally entered one of the Schengen countries, that person can then move within the Schengen area without having to obtain separate visas for each individual country. The UK is not a party to the Schengen Agreement and therefore anyone from outside the EU entering the UK market will be subject to immigration control.

In practice, generally only those franchisors who are either based outside the EU and who wish to enter the EU franchise market by bringing their own staff or UK franchisors and franchise networks who want to make use of skilled workers from outside the EU will be affected.

The UK immigration system is tiered into a number of categories, and entry to the UK can be gained by achieving a certain number of points. Tiers 1 and 2, which are further described below, are the tiers that will be most relevant to franchisors.

Entry clearance must be obtained prior to arrival in the UK. Applicants can use a self-assessment calculator to establish whether or not they score enough points for entry clearance. Effective from 6th April 2011, a permanent cap has been introduced on non-EU immigration to the UK. This will have a direct impact on the ability of UK-based employers to bring in skilled staff from outside the EU. This means, for example, that foreign franchisors who are considering entering the UK market by opening a branch or a subsidiary may have to employ local workers rather than bringing in their own people.

Tier 1 has two categories which may be used by non-European franchisors looking to enter the UK market, namely Tier 1 (Entrepreneur) and Tier 1 (Investor). The requirements for both categories are set out below.

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[164] Belgium, France, Germany, Luxembourg, the Netherlands, Portugal, Spain, Italy, Austria, Greece, Denmark, Finland, Sweden, Iceland, Norway, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia, Switzerland.

The Tier 1 (Entrepreneur) category is for those investing in the UK by setting up or taking over, and being actively involved in the running of one or more businesses in the UK. In order to obtain entry clearance in Tier 1 category, an applicant must prove that he/she has access to £200,000 (roughly equivalent to $320,000) in the UK.

There are also English language requirements.

For those who are investing rather than wishing to be actively involved in a business (Tier 1 Investor) an applicant must procure, amongst other things, that he has money of his own held in a regulated financial institution and disposable in the UK amounting to no less than £1,000,000 ($1,600,000).

Unlike many other categories, the Tier 1 (Investor) category is exempt from the English language requirement.

Under Tier 2 (Skilled Workers) a UK business that wishes to bring in skilled workers from outside the EU to fill a gap in the UK labor market must first register with the UK Border Agency and then "sponsor" their employees. What this means is that an employee is assigned an electronic Certificate of Sponsorship which would then allow that employee to apply for visa clearance in his or her home country before coming to the UK. Once a business becomes a sponsor, it becomes responsible for that person so that if that person does not comply with or breaches any of his or her visa conditions, the employer could be liable to a fine.

It should be noted, however, that certain categories of employees are excluded from the general restrictions, for example the cap will not apply to any intra-company transfers or those coming to the UK for a role with a salary of £150,000 ($240,000) or more.

All visas are granted for a limited period only, usually 3 to 5 years and will need to be extended prior to expiry. Requirements which need to be satisfied on renewal may not, and often are not, the same as those required on entry to the UK and there is no guarantee that an extension will be granted.

C. Other Country Regulatory Issues

In many other countries, franchisors will face regulatory issues similar to those outlined above for the U.S., U.K. and EU. In addition, franchisors may face other regulatory issues in certain countries that impact their international structure, operations or payment of fees. While a discussion of all possible regulatory issues in every country is impossible, outlined below are a few additional common issues that arise in international franchise transactions and operations.

1. Exchange Controls

Exchange controls are regulations that restrict payments or block transfers of funds across borders. Most developed countries allow parties to negotiate royalty rates and to transfer funds across borders without government intervention. However, in other countries, the government regulates payments flowing in and out of the country. For example, the payment of fees from South Africa or Brazil to a foreign franchisor requires exchange control approval. Exchange controls can often result in a delay in receiving fees due under a franchise agreement.

2. Local Ownership

Another regulatory issue is that some countries have local ownership laws that restrict foreign owned businesses. For example, India has restrictions on foreign ownership of retail businesses (other than “single brand” retailing). Local ownership restrictions are also common in the Middle East and China. As a practical matter, especially in a multi-country agreement, local ownership requirements may require the parties to include specific clauses in the agreement to address these transfer and ownership requirements and to facilitate a master franchisee’s or area developer’s ability to meet the local ownership requirements.

X. CONCLUSION

As reflected in the rather far reaching scope of this paper, the sheer number of U.S. and foreign laws that affect the performance of franchise agreements in other countries is vast. Reliance on foreign counsel with significant cross-border experience is essential. In addition, franchisors are wise to consult with experts in fields of law that affect their businesses to be able to make sure they are also in compliance with U.S. laws affecting cross-border transactions.

Exhibit A

INTERNATIONAL FRANCHISE LAWS[165]

Region/Country	Disclosure	Registration	Relationship	Other
North America				
Canada[166]	●			
Mexico	●	●[167]		
Central/South America				
Brazil	●	●[168]		
Venezuela			●	
Europe (EU)				
Belgium	●			
Estonia			●	
France	●			
Lithuania			●	
Italy	●		●	
Spain	●	●		
Sweden	●			
Europe (Non-EU)				
Albania	●		●	

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[165] For more information on franchise registration and disclosure laws, see Andrew P. Loewinger and Michael K. Lindsey (editors), *International Franchise Sales Laws,* American Bar Association Forum on Franchising (2006, 2010 updates).

[166] No national laws, only provincial laws in Alberta, Ontario, New Brunswick and Prince Edward Island. The Manitoba franchise regulations are expected to come into effect in mid-2012.

[167] Registration of Trademark License only

[168] Registration with Ministry of Industrial Property and Central Bank

Region/Country	Disclosure	Registration	Relationship	Other
Belarus			•	
Croatia				•
Georgia	•		•	
Moldova	•		•	
Romania	•		•	
Russia		•[169]	•	
Ukraine			•	
Middle East				
Kuwait		•[170]		
Saudi Arabia			•	
Africa				
South Africa	•[171]			•[172]
Asia				
China	•	•	•	•
Indonesia	•	•	•	
Japan	•			
Kazakhstan		•		
Kyrgyzstan		•		
Macau	•	•[173]	•	

[169] Registration of Trademark License only

[170] Registration of Trademark License only

[171] Effective March 31, 2011

[172] Central Bank permission required to send money outside of the country

[173] Registration of Trademark License only

Region/Country	Disclosure	Registration	Relationship	Other
Malaysia	●	●		
South Korea	●	●	●	
Taiwan	●			
Vietnam	●	●		
Australia	●		●	

NOTES: Does Not Include:

- Codes of conduct which do not provide for governmental or private enforcement, even if promulgated under governmental authority.
- Bodies of law (e.g. competition, intellectual property, etc.) which also cover franchising, unless explicitly mentioned.

Exhibit B

Visa Waiver Program Participating Countries

(As of July 12, 2011)

Andorra	Hungary	New Zealand
Australia	Iceland	Norway
Austria	Ireland	Portugal
Belgium	Italy	San Marino
Brunei	Japan	Singapore
Czech Republic	Latvia	Slovakia
Denmark	Liechtenstein	Slovenia
Estonia	Lithuania	South Korea
Finland	Luxembourg	Spain
France	Malta	Sweden
Germany	Monaco	Switzerland
Greece	the Netherlands	United Kingdom

Exhibit C

Types of U.S. Visas

Purpose of Travel to U.S. and Nonimmigrant Visas	Visa Type	Required: Before Applying for Visa*
Athletes, amateur & professional (compete for prize money only)	B-1	(NA)
Au pairs (exchange visitor)	J	SEVIS
Australian professional specialty	E-3	DOL
Border Crossing Card: Mexico	BCC	(NA)
Business visitors	B-1	(NA)
Crewmembers	D	(NA)
Diplomats and foreign government officials	A	(NA)
Domestic employees or nanny -must be accompanying a foreign national employer	B-1	(NA)
Employees of a designated international organization, and NATO	G1-G5, NATO	(NA)
Exchange visitors	J	SEVIS
Foreign military personnel stationed in the U.S.	A-2 NATO1-6	(NA)
Foreign nationals with extraordinary ability in Sciences, Arts, Education, Business or Athletics	O	USCIS
Free Trade Agreement (FTA) Professionals: Chile, Singapore	H-1B1 - Chile H-1B1 - Singapore	DOL
International cultural exchange visitors	Q	USCIS

Purpose of Travel to U.S. and Nonimmigrant Visas	Visa Type	Required: Before Applying for Visa*
Intra-company transferees	L	USCIS
Medical treatment, visitors for	B-2	(NA)
Media, journalists	I	(NA)
NAFTA professional workers: Mexico, Canada	TN/TD	(NA)
Performing athletes, artists, entertainers	P	USCIS
Physician	J , H-1B	SEVIS
Professor, scholar, teacher (exchange visitor)	J	SEVIS
Religious workers	R	(USCIS)
Specialty occupations in fields requiring highly specialized knowledge	H-1B	DOL then USCIS
Students: academic, vocational	F, M	SEVIS
Temporary agricultural workers	H-2A	DOL then USCIS
Temporary workers performing other services or labor of a temporary or seasonal nature.	H-2B	DOL then USCIS
Tourism, vacation, pleasure visitors	B-2	(NA)
Training in a program not primarily for employment	H-3	USCIS
Treaty traders/treaty investors	E	(NA)
Transiting the United States	C	(NA)
Victims of Human Trafficking	T	USCIS**
Visa Renewals - Available in the U.S.		(NA)

***What the abbreviations (above) mean:** Before applying for a visa at a U.S. Embassy abroad the following is required:

- DOL = The U.S. employer must obtain foreign labor certification from the U.S. Department of Labor, prior to filing a petition with USCIS.

- USCIS = DHS, United States Citizenship and Immigration Services (USCIS) must approve a Form I-129 petition, filed by the U.S. employer. ** A T-1 applicant must have USCIS approval of a Form I-914 application before a family member can apply for a visa.

- **SEVIS** = Program approval entered in the Student and Exchange Visitor Information System (SEVIS)

- **(NA)** = Not Applicable - Means that additional approval by other government agencies is not required prior to applying for a visa at the U.S. Embassy abroad.

Notes:

- Canadian NAFTA Professional workers- Visa not required, apply to CBP at border port-of-entry.

- K visas are for the purpose of marrying a U.S. citizen and immigrating or joining a U.S. citizen spouse in the United States while awaiting USCIS approval of Form I-130 for immigrant status. Visit the immigrant visa section of this website for K-1 and K-3 visa information.

Important Notices: This chart includes nonimmigrant visas and the associated purpose of travel with links to relevant webpages. However, it should be noted this chart is not a complete list of all purposes of travel or types of nonimmigrant visas. Each visa applicant must meet the eligibility requirements for the type of visa for which he/she is applying, as determined by the consular officer at the U.S. Embassy or Consulate, following U.S. immigration laws. See more detailed information on the temporary visitor webpages.

BIOGRAPHIES

Jeffrey A. Brimer has been Special Counsel in the Denver, Colorado office of Faegre & Benson LLP since August 2008. He was Of Counsel in the Denver office of Snell & Wilmer L.L.P. from December 2003 through July, 2008. From October 1988 through November 2003 he was Vice President, General Counsel and Secretary of Medicine Shoppe International, Inc., a St. Louis, Missouri based subsidiary of Cardinal Health, Inc.

He is a graduate of the University of Missouri-St. Louis (B.S. Political Science, summa cum laude, 1976) and the University of Missouri-Columbia School of Law (J.D., 1979), where he was a Member of the Missouri Law Review. He is a member of the American Bar Association (Sections on Business and International Law and Practice, and the Forum on Franchising), the Colorado and Missouri Bars and the International Bar Association.

Mr. Brimer served as a member of the Governing Committee of the Forum on Franchising from August, 2000 to August 2005. He also served as the Chair of the Long-Range Planning Committee of the Forum on Franchising and on the ABA Section Officers Committee – CLE Task Force. He was Programs Officer of the Forum from August 2002 until May 2004 and was co-chair of the ABA Annual Forum on Franchising, held in Scottsdale, Arizona in October, 2002. He was a member of the Steering Committee of the Corporate Counsel Division of the Forum on Franchising from August, 1994 through August, 2000 and served as the Director of the Division from August, 1998 through August, 2000. He is a member of the International Franchise Association Legal-Legislative Committee.

Mr. Brimer has written and spoken on a variety of franchise issues at programs held by the ABA Annual Forum on Franchising, the International Franchise Association Legal Symposium and Annual Meetings, the Bar Association of Metropolitan St. Louis, the Kansas City Bar Association, the Colorado Bar Association, the Denver Franchise Business Network, the International Bar Association and the International Distribution Institute. He is the editor of the second edition of the *Franchise Law Compliance Manual*, to be published by the American Bar Association Forum on Franchising in 2011.

Mr. Brimer has been named to The International Who's Who of Franchise Lawyers, Franchise Times “Legal Eagles”, Chambers USA: America’s Leading Lawyers for Franchising and Best Lawyers in America.

Alison (Ali) McElroy is General Counsel with Snap Fitness, Inc. in Chanhassen, MN. She is responsible for overseeing all aspects of Snap Fitness’ legal affairs, including international franchising. Ms. McElroy was previously in private practice in Minneapolis, MN with the law firm Faegre & Benson LLP where her practice included franchise and distribution law, international business transactions, international corporate counseling and mergers and acquisitions. Prior to joining Faegre & Benson, Ms. McElroy was a judicial clerk for Chief Justice Kathleen Blatz of the Minnesota Supreme Court (now retired). Ms. McElroy received her B.A. from the University of Notre Dame and her J.D. from the University of Minnesota Law School. Ms. McElroy is a member of the American Bar Association Forum on Franchising, a past chair of the Minnesota State Bar Association Section of International Business Law and holds a Certified Franchise Executive designation from the International Franchise Association.

John H. Pratt is the immediate past Legal Advisor to the British Franchise Association and a past Chair of the International Bar Association’s International Franchise Committee. He is the current Director of the American Bar Association's International Franchising Division. He has written "Franchising: Law & Practice", "The Franchisor's Handbook" and contributed the franchise section of a number of franchise publications. John obtained his law degree from Oxford University and completed a doctorate course in Comparative Law at the Université d'Aix-Marseille. He is a past President of Birmingham Chamber and Honorary French Consul. He is a Director of the NEC – Europe's largest exhibition company.