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**Fundamentals 201: The Art and Science of
Drafting Multi-Unit Development Agreements**

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Attachment 1 Summary of Multi-Unit Arrangement Terminology and Key Hallmarks

Attachment 2 Sample Provisions from Multi-Unit Development Agreements

FUNDAMENTALS 201: THE ART AND SCIENCE OF DRAFTING MULTI-UNIT DEVELOPMENT AGREEMENTS

I. INTRODUCTION¹

As the expansion of branded chain businesses (be they restaurants, lodging facilities, retail stores, or service businesses) continues, brand owners are increasingly looking to multi-unit development arrangements as an efficient mechanism to grow their systems. The benefits of multi-unit (as opposed to one-off) development are numerous, including efficiencies of scale inherent in dealing with fewer (and, often, more sophisticated counterparties), particularly in the context of international development. There are risks, however, the most obvious of which is selecting the wrong development partner.

This paper briefly describes the principal types of multi-unit development arrangements and significant risks and advantages of each. Elements of art and science exist in developing appropriate documentation for a multi-unit development program. Some fundamental concepts must certainly be included in any such program, but thoughtfulness and creativity are hallmarks of multi-unit development arrangements that are built to last—a narrow, “one size fits all” approach generally will not serve the long-term requirements of a growing system. Therefore, this paper focuses on drafting considerations in various multi-unit development arrangements, as well as key regulatory issues that arise in the multi-unit development context. Though the franchise model in its various forms is likely the most prevalent model used for expansion of branded chains both in the U.S. and abroad (and, therefore, is the focus of this paper), this paper also addresses alternative structures, including joint ventures.

II. TYPES OF MULTI-UNIT DEVELOPMENT ARRANGEMENTS; TERMINOLOGY

Unit franchising is the most basic structure through which a franchisor, as the owner of the trademark and system, licenses those assets to a third-party franchisee for use at a defined location or in a specified market. While extremely effective, franchising as a growth vehicle for many businesses is further enhanced by the myriad of franchise structures that exist beyond unit franchising. These structures range from area development agreements on one end of the spectrum to true three-party arrangements such as master franchising on the other end, and include various other structures that fall in the “gray” area in between (e.g., area representative arrangements, joint ventures, and brokerage arrangements). A chart summarizing the terminology associated with each multi-unit development structure—and their key hallmarks—is attached as Attachment 1.

A. Master Franchise Arrangements

1. Description and General Objectives

Master franchising, for all of its benefits, is not for the faint of heart. In a true master franchise arrangement, the franchisor delegates nearly all pre-sale and post-sale obligations as to unit franchisees (or, as they are more commonly referred to in this context, “subfranchisees”) in a market to a third-party master franchisee. The hallmark of master franchising is that, short of retaining the right to ultimately approve or reject subfranchisee candidates proffered by the master franchisee and specifying the form of unit franchise agreement that the master

¹ The authors wish to acknowledge Paul Russell, an associate in the Dallas office of Baker Botts L.L.P., for his assistance in preparing this paper.

franchisee must use with its subfranchisees, the franchisor delegates all pre-sale and post-sale activities in a specified geographic region to the master franchisee who effectively acts as the franchisor. Perhaps not surprisingly, master franchise arrangements are most typically used in international expansion efforts where U.S. franchisors must rely on the local knowledge of foreign nationals to offer, sell and support subfranchises in foreign countries—and, sometimes, even to help design how the “look and feel” of the franchisor’s concept must evolve to achieve consumer success in the local market. If a franchisor aligns itself with a sophisticated and experienced master franchisee, it can realize one of the key benefits of the master franchise approach—aggressive growth and increased brand recognition with minimal franchisor-invested dollars in the market.

2. Advantages and Disadvantages

a. Advantages

Aggressive unit-level growth and brand awareness with minimal franchisor investment is a (if not *the*) primary advantage associated with a master franchise arrangement. Depending on the qualifications and experience of the master franchisee as well as the potential of the local market, a franchisor that aligns itself with the right master franchisee can expand its international footprint much more quickly than if it were to attempt to expand internationally through direct franchise arrangements between it and foreign unit-level franchisees (or even through company-owned outlets). The master franchisee will interact with its subfranchisees as the “franchisor” in the business relationship, essentially policing and enforcing the subfranchisees’ compliance with the unit franchise agreement, and will remit a portion of all fees collected from the subfranchisee to the franchisor. Thus, the franchisor enjoys the financial benefits of the brand’s foreign-based subfranchisees without the burdens associated with directly managing a foreign-based, unit-level franchised business relationship.

As with other types of multi-development growth arrangements, franchisors realize greater up-front financial benefits through master franchising as compared to unit franchising. On an international basis, it is not uncommon for franchisors to charge a significant initial master franchise fee in connection with the offer and sale of master franchise rights. For example, a franchisor that awards an entire country to a master franchisee might charge a mid- to high-six figure amount for those franchise rights. Similarly, it would not be uncommon for a franchisor awarding an entire region composed of several geographically-aligned countries to charge more than seven figures simply for the right to act as the master franchisee for that region.

Economics aside, the master franchisee’s local presence—especially when coupled with local laws and customs—provides a key, on-the-ground resource for subfranchisees in the market. Often, the master franchise agreement will require the master franchisee to develop and operate at least one (if not more) franchised units, which will broaden the master franchisee’s operational knowledge base and provide additional benefit to subfranchisees.

b. Disadvantages

Delegation of effectively all pre-sale and post-sale controls, and the risks associated with this delegation, is the primary disadvantage associated with the master franchise arrangement. The relinquishment of control is particularly difficult for franchisors making their first foray into the international market as the very thought of allowing a third-party to control the brand’s roll-out in a foreign market is a concept completely foreign to them. Franchisors that find a way to get past that issue eventually come to terms with the fact that they will never have the kind of

brand and system controls in a master franchise arrangement that they have in their unit franchise arrangements (and even in their other multi-development arrangements, like area development and area representative arrangements).

While the franchisor can collect greater up-front amounts from master franchisees in terms of the initial master franchise fee, the franchisor will incur significant costs to ready itself for a master franchise opportunity. First, even in countries with no pre-sale disclosure and registration obligations, wise franchisors will use some form of disclosure (likely based off of the U.S. Franchise Disclosure Document, or “FDD,” model) to ensure that potential master franchisee candidates receive information material to the business opportunity. Accurate pre-sale disclosures, and conversations consistent with those disclosures, can go a long way in terms of staving off successful fraud and misrepresentation claims from an aggrieved master franchisee.

Second, the franchisor very likely will spend significant time and money exploring the cultural modifications that must be made to the franchise concept prior to launching in each foreign country (and, in some cases, in different regions of the same country). Menu modifications, “look and feel” changes, and even changes to the trademarks and trade name themselves often result from this type of critical analysis, and franchisors will no doubt engage outside business consultants, lawyers and accountants to help them navigate these issues.

Third, because most master franchisees will be significant business entities, franchisors can expect much negotiation as to the terms of any master franchise arrangement, which may impact the franchisor’s economic expectations resulting from the master arrangement. Examples of commonly negotiated terms include fees (both the initial master franchise fee as well as the “split” of the ongoing fees), territory, rights of first refusal (often for a reduced or no up-front investment by the master franchisee) on different or neighboring countries or regions, the term of the parties’ business relationship, and grounds for default and termination.

Finally, franchisors will experience increased costs for the preparation and registration (in some countries) of a separate FDD that describes the franchisor’s master franchise offering. In the U.S., franchisors likewise will experience increased costs to disclose the master franchise offering in its standard U.S. FDD, or to prepare and register a separate FDD disclosing the master franchise opportunity. In any case, the franchisor also will work closely with the master franchisee and incur additional expenses geared toward ensuring that the master franchisee’s own FDD (which it is required to prepare pursuant to applicable law) contains accurate disclosures related to the franchisor and its core franchise program.

B. Area Development Arrangements

1. Description and General Objectives

Area development arrangements are most closely (albeit not completely) aligned with the concept of unit franchising. Under an area development model, a franchisor enters into an area development agreement with a third-party developer whereby the developer commits to develop and operate (either itself or through a controlled affiliated entity) a specified number of units in a geographic area. This structure allows the franchisor to retain sole control over its traditional pre-sale and post-sale support roles, while at the same time encouraging faster unit growth by requiring the developer to adhere to a specific development schedule.

The area development model often results in a hybrid between traditional unit franchising and three-party franchising. This is because most (but not all) area developers will delegate the actual development and operational duties for each unit specified in the development schedule to an affiliated entity, that then will enter into a separate unit franchise agreement with the franchisor. In this way, the area developer is bound by its contractual obligations to the franchisor in the area development agreement (i.e., ensuring that its affiliated entity develops and opens the number of units within the timeframes contemplated by the development schedule), while the affiliated franchisee entity is bound by its own contractual obligations to the franchisor in the unit franchise agreement (i.e., opening and operating the unit franchise in accordance with the franchise agreement terms).

Area development arrangements are most commonly used by franchisors who wish to expand in domestic markets where it does not already have a physical presence, as sometimes the local knowledge of real estate markets and key connections with licensing boards can make the difference between aggressive growth and inconvenient road blocks. Some franchisors also leverage the area development model internationally because they wish to retain pre-sale and post-sale support roles, although international expansion through an area development model is not a common approach.

2. Advantages and Disadvantages

a. Advantages

The primary advantage in an area development arrangement is the franchisor's ability to encourage faster unit growth through an aggressive (but realistic) development schedule without compromising important pre-sale and post-sale controls. These pre-sale and post-sale controls span everything from candidate validation at the beginning of the sales process to enforcement of system standards and other obligations that kick in after the parties sign the agreement. No matter the benefits associated with tri-party franchise arrangements like master franchising and area representative arrangements, some franchisors cannot easily move beyond the area development model because they are uncomfortable with relinquishing some or all of these controls to a third-party.

In addition to encouraging faster growth and the intrinsic value associated with maintaining tight controls over pre- and post-sale obligations, franchisors realize greater up-front economic benefits by awarding area development rights as compared to the traditional unit franchise model. These greater economic benefits flow from the separate "area development fee" that a franchisor assesses as a condition of entering into the area development agreement.

The area development fee is in addition to the initial franchise fee that must be paid as each franchise agreement is signed for the developed units. The actual amount of the area development fee varies by franchisor and industry, but generally amounts to a mid- to high five-figure payment depending on the number of units to be developed, length of development timeline and the perceived value of the geographic area awarded to the developer. Some franchisors allocate a portion of the area development fee toward the initial franchise fee for each restaurant (thus, resulting in the developer/franchisee affiliate paying less toward the initial franchise fee for each resulting unit), while others view the development fee as a separate payment due to the franchisor only for the developer's right to lock up a geographic territory for a set period of time in furtherance of its development obligations.

b. Disadvantages

As with any other franchising model, area development arrangements are not without drawbacks. The very reason that some franchisors choose an area development model over a true three-party arrangement (i.e., the ability to retain important pre- and post-sale controls) necessarily results in greater time commitment and economic resources directed at cultivating, monitoring and maintaining the resulting business relationship—resources that could be saved or allocated to other projects important to the franchise system simply by delegating some of these responsibilities to a third-party.

Another perceived disadvantage in the area development model stems from the size of geographic territories that are awarded. Under an area development arrangement, the geographic area granted to the area developer will be much larger than that associated with the sale of a single unit franchise (as it ultimately will hold multiple units). To be clear, the award of a larger geographic territory, in and of itself, does not give rise to the perceived disadvantage in an area development model. Rather, the disadvantage arises when the developer does not carry out its development obligations pursuant to the contractual development schedule, which results in a valuable geographic area sitting stagnant rather than maximizing its potential for the benefit of the brand and franchise system. In this all too common scenario, the franchisor must act swiftly to manage the situation and protect its interests, even if that means terminating (or significantly reducing the scope of) the area development rights if the developer truly cannot perform on the obligations. Franchisors that lack the manpower and diligence necessary to protect their interests in these situations are wise to think twice about offering large area development rights in key geographic territories, and might instead focus on awarding development rights for a smaller number of units.

C. Area Representative Arrangements

1. Description and General Objectives

Area representative arrangements are one of two traditional three-party franchising models. Unlike master franchising, which is the other true three-party model that delegates both the pre-sale and post-sale obligations to a third party (i.e., the master franchisee), an area representative model delegates only *certain* pre-sale and post-sale obligations to the area representative. Through an area representative agreement, the franchisor authorizes the area representative (sometimes also known as a “development agent” or “regional representative”) to help advertise and promote the franchise opportunity in the relevant market area, engage potential franchise candidates in discussions about the franchise system and franchise opportunity, and, if the franchisor ultimately decides to award a franchise to the potential candidate, provide ongoing operational support and guidance to the resulting franchisee (e.g., operational support, site selection assistance, training, and so on).

Notably, under an area representative arrangement, the franchisor will enter into two types of contractual arrangements: an area representative agreement with the area representative, and a unit franchise agreement with the resulting franchisee. No direct contractual relationship will exist as between the area representative and the unit franchisee. The area representative agreement will detail both the scope of the area representative’s obligations (briefly summarized above) and the relevant geographic area in which they are to be performed.

The area representative agreement also typically will specify that, in exchange for these services, the area representative will receive a portion of the initial franchise fee, as well as a portion of the ongoing royalty fee, paid by the resulting franchisee to the franchisor. For absolute clarity, the agreement also should detail the pre-sale and post-sale functions and responsibilities reserved exclusively to the franchisor—e.g., determining to award a franchise to any candidate referred by the area representative, collecting initial and ongoing fees from the unit franchisee, ultimate say with respect to the acceptance of any proposed site for the franchised business, enforcing brand standards, default and termination rights, and so on. The scope of delegated responsibilities in an area representative arrangement varies among franchise systems. The unit franchise agreement, which then is entered into between the franchisor and the franchisee, provides the franchisor with direct contractual privity so that it can manage and enforce its rights related to that specific franchisee and the unit in question.

2. Advantages and Disadvantages

a. Advantages

The area representative structure is enticing to franchisors that are more comfortable with the thought of delegating some, but not all, pre-sale and post-sale obligations to a third-party. From a pre-sale perspective, permitting a trusted third-party area representative to recruit and interview potential franchise candidates, as well as take them through the franchisor's validation process to determine if they (i) meet the franchisor's then-current standards for new franchisees generally, and (ii) present an overall good "fit" with the franchise system's culture and values, means the franchisor is free to devote the significant resources that otherwise would be tasked with these functions to different areas of focus in the business. For example, rather than having two or three franchise sales people on staff to vet candidates, a franchisor utilizing an area representative likely will be able to reduce its internal staff count and allocate resources for salary, benefits and overhead elsewhere.

Franchisors can experience greater unit growth through an area representative arrangement as compared to unit franchising over the same period of time. An area representative has a direct economic incentive to locate qualified candidates for the franchisor's approval, as evidenced by the typical structure in which the area representative receives a portion of the initial franchise fee and ongoing royalty fee. Accordingly, an area representative is apt to work the local market in a more focused manner in an effort to locate qualified candidates for the franchisor's ultimate approval as compared to franchisor sales personnel who, by virtue of taking a more global approach to their franchise sales efforts (i.e., trying to work multiple markets and leads at one time), may be unable to make the same kind of impact in any particular area. To maximize the likelihood of positive impact on unit sales through an area representative arrangement, the geographic area awarded to the area representative should be large enough to accommodate a sufficient number of new unit sales but small enough to ensure the area representative's ability to remain focused in its franchise sales and support efforts.

Delegating some of the important post-sale functions to a trusted third-party allows the franchisor to focus on monitoring and enforcing the essential aspects of its business relationship with each unit franchisee; these essential aspects of the relationship include matters such as adherence to brand standards, collection of amounts owed and making the ultimate call with respect to default and termination matters. Area representatives demonstrate in many ways their value in the ongoing business relationship between the franchisor and the unit franchisee. For example, because area representatives typically operate their own unit franchises, they are

highly valued resources to unit franchisees for initial and ongoing training, including the “informal” training that results from fielding the variety of operational questions that franchisees face every day as business owners. Also, because area representatives typically know the nuances of the local real estate market and land developers better than the franchisor, they can assist the franchisee in vetting potential sites before any site makes its way to the franchisor for final acceptance—thus, resulting in the franchisee’s ability to focus its energies on acceptable sites and, ultimately, increased efficiencies for the franchisor in terms of rendering its site acceptance.

Some franchisors also allow the area representative to review the unit franchisee’s proposed local consumer sales advertising for any potential issues prior to publication, while other franchisors allow the area representative to merely take the first “pass” through the ad from a brand compliance standpoint before forwarding any local advertising to the franchisor for final review and approval. The ultimate approach to this and other issues relates as much to the franchisor’s comfort level with respect to delegating certain operational controls as it does to the particular area representative’s experience.

b. Disadvantages

Delegating certain pre-sale and post-sale obligations to a third-party is not without risk. One aspect of the area representative arrangement that breeds risk is the pre-sale process in which the area representative takes an active role recruiting and engaging prospective candidates. As explained in Section IV below, the franchise sales process is heavily regulated at the federal and state level and simply delegating certain pre-sale functions to a third-party does not absolve the franchisor from the “sins” committed by an area representative during the pre-sale process. Thus, the franchisor is wise to manage this risk by ensuring that the area representatives with whom the franchisor contracts are sophisticated business people who understand franchising’s regulatory framework and who have a demonstrated track record of successfully engaging in an area representative role within that framework.

Delegating certain post-sale functions to an area representative can create unintended distance between the franchisor and unit franchisee. Yes, the franchisor maintains contractual privity with the unit franchisee under an area representative model, but the mere existence of that privity will not lessen the strength of the bonds formed between the area representative and the unit franchisee. Under an area representative model, the area representative will be the franchisor’s first line of defense, so to speak, with respect to various ongoing training and operational matters related to unit franchisees. If the area representative does its job well, the area representative and unit franchisee will interact on a regular basis about the unit franchisee’s business and the franchise system in general. The franchisor must understand this reality and proactively take steps to engage unit franchisees regarding their business and the franchise system generally so as to prevent any perceived or actual distance in the business relationship between the franchisor and unit franchisee. Franchisors also must closely monitor area representatives to ensure that they themselves are following the franchisor’s directives with respect to the delegated tasks and otherwise upholding the franchisor’s system standards, as failure to do so will create inconsistent messaging to the unit franchisee.

Moreover, under the traditional area representative model, area representatives operate their own unit-level businesses in addition to carrying out their post-sale area representative support duties. While an area representative’s direct experience operating the unit-level business provides the franchisees it supports with valuable “on the ground” insight into various

aspects of the business, it also can result in the area representative spending less time in the “franchisee support” role.

Finally, a franchisor will have increased disclosure obligations related to the area representative program and its impact on potential unit franchisees. As outlined in Section IV below, franchisors will incur legal fees and related costs associated with accurately disclosing key features of the area representative program in its FDD and in registering the franchisor-to-area representative offering with registration states, as well as investigating whether a separate area representative-to-unit franchisee FDD must be prepared and filed prior to the area representative undertaking any franchise sales efforts.

D. Other Structures, including Joint Ventures

There are a variety of other, less-common, structures under which a franchisor may elect to expand through multi-unit development. A joint venture is an arrangement that is sometimes used in the context of international development whereby the brand owner/franchisor enters into a contractual relationship with a local party to develop units together in a particular market or markets. A formal joint venture entity may be formed to conduct such development, but often no separate entity is formed and the parties, instead, form what is essentially a general partnership. Local law and customs typically drive the decisions regarding the particular structure used.

In a joint venture, the franchisor contributes a license to use and sublicense the intellectual property and may contribute capital, and the joint venture partner generally contributes capital, operational capabilities and its knowledge of the local market, which is one of the primary reasons that a franchisor may consider a joint venture arrangement. Often, the grant of master franchise or area development rights to the joint venture company is a component of joint venture arrangements.

The franchisor can benefit from a joint venture relationship by entering a new market relatively quickly with a partner that can help navigate that market while retaining a higher degree of control and a greater share of the profits than is afforded under a straight master franchise or area development relationship. The risks of a joint venture include the potential loss of any capital contributed by the franchisor and, importantly, that the wrong joint venture partner is chosen. Even with joint venture agreements that contain strong protections for the franchisor’s intellectual property and exit strategies in favor of the franchisor, a franchisor most likely will find it difficult and costly to extricate itself from a joint venture arrangement. A franchisor therefore should carefully consider whether a joint venture (and the joint venture partner) is right for the company and conduct thorough diligence before entering into any relationship.

Other structures include hybrid arrangements, e.g., a master franchisee may be required to develop a certain number of units under an area development agreement before being granted the master franchise rights for a particular area, or a master franchisee may be granted the right to offer both unit subfranchises and area development rights. Franchisors may also consider granting rights of first refusal or rights of first option agreements, under which the franchisor grants a franchisee the right to develop multiple additional units if, as, and when the franchisor elects to begin developing the market before offering the right to develop additional units to a third party or developing units in the market itself.

III. DRAFTING MULTI-UNIT DEVELOPMENT CONTRACTS

After determining the type of multi-unit development arrangement that will be implemented in a particular system, the appropriate contracts must, of course, be developed. This section addresses contract structuring considerations; explores key provisions contained in most (if not all) multi-unit development contracts and special drafting considerations that arise in the context of master franchise agreements, area development agreements, and area representative agreements; and identifies certain issues that must be addressed in international multi-unit development contracts.

A. Contract Structuring Considerations

As discussed in Section I above, any well-structured multi-unit development arrangement contemplates two discrete levels of activity: activity at the “developer level” and activity at the “unit level” or “operational level.” The parties engaged in the developer level and unit level activities may be the same or related (as in the area development context or when a master franchisee develops its own units); or the parties engaged in the developer level and unit level activities may be different and unrelated (as in the area representative context or when a subfranchisee that is unrelated to the master franchisee develops a unit). In either case, this two-level structure requires that the relative rights and obligations of the parties at each level are addressed in one or more contracts.

One of the threshold issues in developing any multi-unit development program is determining the structure (including the number) of the core contract(s) to be used in the program. As a general rule, it is often advisable to document the developer level rights and obligations in a separate contract from operational level rights and obligations for a variety of reasons, both practical and legal. Those reasons may include that there are different parties with different interests at the two levels; a need to maintain a clear line of distinction with respect to respective responsibilities of the parties; and the desire to be able to easily terminate or modify the relationship at one level without impacting the other level. For example, in a master franchise structure, a “Master Franchise Agreement” generally addresses the developer level activities, and a “Subfranchise Agreement” generally addresses the operational level activities. Yet, almost without exception, in an area representative structure, the “Area Representative Agreement” will address the developer level activities while the “Franchise Agreement” will address the activities at the operational level.

Despite these considerations, and depending on the particular circumstances, a single contract addressing activities at both levels may be a viable option, such as in an area development arrangement where a single entity will be the area developer and will operate all of the units. In that circumstance, a single contract could contain both development components of the relationship as well as the unit development and operational components. Using a single contract may be a particularly attractive method to control costs and confusion in the context of an international multi-unit development transaction where the counterparty does not speak the brand owner’s language and/or a translation of the documents is required. Of course, the benefits and costs of utilizing this type of streamlined structure must be carefully considered.

Multi-unit development agreements take many different forms. Decisions made regarding the overall structuring of the contracts will, obviously, have an impact on the provisions included (and not included) in the agreement.

B. Key Provisions

This section discusses key provisions of multi-unit development agreements generally and identifies some special drafting considerations for master franchise agreements, area development agreements, and area representative agreements. We also address some issues that need to be addressed in multi-unit development agreements for cross-border transactions. Samples of certain provisions are included in Attachment 2 to this paper as indicated below.

1. Grant and Territorial/Exclusivity Provisions

a. General

The grant of rights is a fundamental part of any multi-unit development agreement. A well-drafted grant should specify exactly what rights are being granted and state that the grantee is obtaining no other rights other than those specifically granted in the agreement.

If the agreement is territorial in nature (whether exclusive or non-exclusive), the grant should also clearly describe the territory/area in which the grantee may exercise the rights granted. Additionally, if exclusivity of any type is being granted, the nature of such exclusivity (i.e., what the grantor agrees not to do in the exclusive area) should be clearly stated and a reservations of rights in favor of the grantor to do everything else should be included.

b. Special Drafting Considerations

i. Master Franchise Agreements

At a minimum, the master franchise agreement should grant the master franchisee the right to license third parties (subfranchisees) to operate the business which is the subject of the franchise. The grant may permit (or require) the master franchisee or one of its affiliates to operate one or more of those businesses under a separate unit franchise agreement for each such business. In either case, the master franchisee's rights should be limited to a defined area.

In the context of third-party subfranchises, the master franchisee will be required to enter into subfranchise agreements with the third-party subfranchisees, generally in compliance with a development schedule (See section III.B.3 below). Although the form of subfranchise agreement that the master franchisee must use (which typically is prepared initially, and subject to further modification, by the franchisor) is often attached as an exhibit to the master franchise agreement, that is not always the case. If the form of subfranchise agreement is not attached, the franchisor should, at a minimum, require that the form of subfranchise agreement that the master franchisee uses be approved before its use by the master franchisee.

Alternatively, a summary of key provisions that must be included in the subfranchise agreement may be attached, but, even under this approach, the form of subfranchise agreement that the master franchisee proposes to use should be submitted to and approved by the franchisor. Attaching a form of subfranchise agreement and requiring the master franchisee to use that form affords the franchisor the most control and is, therefore, the approach that is advised most often absent unusual circumstances.

With respect to subfranchised units that are developed and operated by the master franchisee or one of its affiliates, the master franchisee or its affiliate may be required to enter

into a separate unit franchise agreement with the franchisor for the unit or, in the alternative, the master franchisee may have the right to enter into subfranchise agreements with itself or the affiliate (in which case, the franchisor would have the right under the master franchise agreement to enforce the terms of the unit franchise agreement directly against the master franchisee or its affiliate).

Most master franchise agreements provide the master franchisee with some measure of territorial protection in a defined geographic area. As part of the territorial protection granted to the master franchisee, the franchisor may agree not to open any company-owned locations, grant additional master franchises, or grant unit franchises in the master franchisee's protected area. Notwithstanding the limited territorial grant, it is advisable for franchisors to reserve the right to grant master franchises and unit franchises and operate company-owned units outside of the master franchisee's protected area and to advertise and distribute products and services under the franchisor's trademarks and other trademarks through alternative channels of distribution within the master franchisee's territory.

ii. Area Development Agreements

The grant under most area development agreements is limited to the grant of rights to develop a certain number of units within a certain period of time (usually set forth in a development schedule). Importantly, area development agreements typically do not grant the area developer the right to open or operate franchised units and, quite often, will specifically provide that the area developer is not granted any right to operate units and has no right to use the marks under the area development agreement. As noted above, most frequently, franchised units developed pursuant to an area development agreement are opened and operated under separate unit franchise agreements that are signed after (and in some cases at the same time as) the area development agreement is signed.

Almost all area development agreements contain some form of territorial protection under which the franchisor agrees not to develop or permit others to develop the relevant units under the marks. As with other forms of multi-unit development arrangements, area development agreements should contain a comprehensive reserved rights provision under which the franchisor reserves the right to engage in, and permit others to engage in, any activities for which the franchisor has not specifically granted the area developer the exclusive right.

iii. Area Representative Agreements

The grant in an area representative agreement generally provides that area representative has the right in a defined geographic territory to market the franchise opportunity, identify and recruit qualified prospective franchisees, and provide certain post-sale services to franchisees on behalf of the franchisor in the area representative's territory. Typically the grant will be conditioned on the area representatives having a franchised unit for the underlying business open and operating so that the area representative has "on the ground" experience with respect to operating a franchised unit and can have a unit from which to provide training to franchisees in the area representative's territory.

If the franchisor has existing unit franchisees in the area representative's territory at the time that the area representative agreement is signed, the area representative agreement must address whether the area representative will be responsible for servicing those existing franchisees and related transitional issues. Well-drafted franchise agreements often provide

that the franchisor may delegate its obligations under the franchise agreement to a third party (e.g., an area representative), but, whether or not such delegation language is present, the franchisor must ensure that the existing franchisees are “on-board” with the area representative arrangement.

Area representative agreements often provide that the franchisor will not grant other area representative rights in the area representative’s territory. Consideration should be given to specifically reserving the right for the franchisor to offer franchises for the underlying business anywhere (including within the area representative’s territory). Even if franchisors reserve such right, they will typically refer any leads for potential franchisees in the area representative’s territory to the area representative so that the area representative can be credited for any franchise sales in its territory and can provide post-sale services to those franchisees. Area representative agreements may also reserve the right for the franchisor to open and operate company-owned units within the area representative’s territory, in which case company-owned units developed in the area representative’s territory will count towards the area representative’s development obligations. However, area representatives generally will not receive compensation with respect to those company-owned units since the area representative is not required to support those units.

Sample grant and territorial provisions from a master franchise agreement, an area development agreement, and an area representative agreement are included in Attachment 2.

2. Term/Renewal

a. General

Multi-unit development agreements should provide for a term (in years or some other defined period) during which the agreement is effective. Although not as common as in unit franchise agreements, some multi-unit development agreements may contain a renewal right in favor of the area developer which can be exercised if certain stated conditions are met or upon mutually agreed terms and a new development schedule.

b. Special Drafting Considerations

i. Master Franchise Agreements

Term provisions in master franchise agreements are far more nuanced and complex than simply stating that the term of the master franchise agreement is for a certain number of years. For instance, the master franchise agreement may provide that the “development term” (i.e., the time period during which the master franchisee can recruit subfranchisees and enter into new subfranchise agreements) is a certain number of years, and that following the expiration of the development term (or a successor or renewal development term) the master franchisee may continue to have its “operating rights” (i.e., the right to act as the subfranchisor with respect to the existing subfranchisees and continue to receive compensation for those services as provided under the master franchise agreement), but no rights to further develop the territory. On the expiration of the development term, the territorial protection granted to the master franchisee would terminate, and, subject to any territorial rights of subfranchisees contained in the subfranchise agreements, the franchisor would have the right to further develop the territory itself or authorize a third party to do so. Under this structure, the term of the master franchise agreement as it relates to the operating rights will typically continue until the expiration or termination of the last then-existing subfranchise agreement, unless, of course, the operating

rights under the master franchise agreement are terminated in accordance with the terms of the master franchise agreement.

ii. Area Development Agreements

Given the nature of the rights granted under area development agreements, the term of an area development agreement generally is tied to the development schedule. An area development agreement may provide that the term begins on the date of execution (or some other specified date) and ends on the earlier of the date that the area developer has completed its development obligations under the area development agreement or the expiration of the development schedule (e.g., the date by which the last franchise agreement contemplated by the development schedule must be signed). The development rights and related territorial rights end on the expiration of an area development agreement, but the individual franchise agreements executed pursuant to the area development agreements remain in place and govern the operation of the franchised units.

Since there is no purpose for an area development agreement following the execution of the number of franchise agreements contemplated by the development schedule, most area development agreements do not provide for a renewal right. However, area developers may want to have the opportunity to conduct additional development following the fulfillment of the development schedule. To address this, instead of granting a “renewal right,” the franchisor may consider agreeing to negotiate an extension of the development rights following fulfillment of the original development schedule, and, if the parties can agree on a new development schedule, enter into a new area development agreement upon the expiration of the original area development agreement, provided that other conditions (e.g., the developer being in good standing, execution of a general release, etc.) are met.

iii. Area Representative Agreements

Term provisions in area representative agreements are relatively straightforward. Area representative agreements typically run for a specified initial term, usually a number of years, and may contain a right to renew for one or more renewal terms if the area representative satisfies certain conditions.

Sample term and renewal provisions from a master franchise agreement, an area development agreement, and an area representative agreement are included in Attachment 2.

3. Development Schedule/Quotas

a. General

A requirement that the developer party actually develop (in whatever function) a certain number of units within a specified period of time is inherent in any multi-unit development arrangement. In order to fully exploit the particular market, it is critical that the applicable agreement have clear and strong provisions requiring such development and that the franchisor enforce those provisions.

b. Special Drafting Considerations

i. Master Franchise Agreements

A master franchise agreement should include a development schedule that sets forth deadlines by which a specified number of subfranchise agreements must be signed and/or subfranchised units must be opened, both on a development period and cumulative basis. In most cases, interim deadlines related to, for example, site approval and execution of the lease by the subfranchisee will be contained in the subfranchise agreement as opposed to the master franchise agreement.

The development schedule can be set forth in the body of the agreement or in an attachment, but, in either case, the underlying master franchise agreement must contain provisions that require the master franchisee to meet the requirements of the development schedule. The specific development requirements will vary depending on various factors including the type of business and the size, population, and demographics of the territory. In some master franchise transactions (e.g., where the territory is comprised of a large country or multiple countries) the development schedule may be broken down into market areas within the territory. This approach gives the franchisor more precise control over the manner in which the brand expands within the territory.

As noted above, enforcement of the development schedule is crucial. Master franchise agreements should state that a failure to meet the requirements of the development schedule is a default under the agreement. The remedies for failure to meet the development schedule should be drafted to give the franchisor maximum flexibility. For example, in certain circumstances, the franchisor may wish to terminate the entire master franchise agreement if the master franchisee does not meet the development schedule after being provided with a reasonable cure period, but, in other circumstances, the franchisor may not want to terminate the master franchise agreement immediately, but, instead, modify the development schedule and/or the territory. As a practical matter, however, if the master franchisee is unable to meet its development schedule but is otherwise performing its obligations under the master franchise agreement, the parties often will agree on a modification to the development schedule or some other mutually acceptable way forward.

ii. Area Development Agreements

An area developer generally has a right and obligation under its area development agreement to develop (either itself or through a controlled affiliate) a certain number of units within a certain period of time. The development schedule in an area development agreement typically sets forth the number of franchise agreements that must be signed and units that must be opened by certain deadlines.

The operative provisions relating to the development schedule sometimes will provide that the area developer may not exceed the number of units called for under the development schedule during a particular development period without the franchisor's consent. This mechanism ensures that the area developer does not get "ahead of itself" in developing units. If the franchisor consents to accelerated development, the units that are developed ahead of schedule will count toward subsequent development period requirements. However, area development agreements should prohibit area developers from opening more than the cumulative number of units contemplated by the development schedule.

If a unit that has been developed pursuant to an area development agreement is closed, it usually will not continue to be counted towards the development schedule requirements and must be replaced within a certain period of time for the area developer to remain in compliance. However, if such a unit is transferred (with the franchisor's approval) to a new owner it may continue to be counted toward the development schedule so long as it continues to be operated under the brand.

iii. Area Representative Agreements

Of the three primary forms of multi-unit development agreements, area representative agreements are least likely to specify a development schedule or quota, although some do. This is likely due to the more "freeform" nature of many area representative relationships and that area representatives generally have a larger territory or area of responsibility than other multi-unit developers. In the absence of a development schedule, area representatives should, at a minimum, be required to use "good faith" or "best efforts" to recruit, solicit, and screen prospective franchisees.

Sample development schedule/quota provisions from a master franchise agreement, an area development agreement, and an area representative agreement are included in Attachment 2.

4. Fees/Compensation

a. General

From a business standpoint, the fee provisions in multi-unit development agreements are some of the most important. Generally, multi-unit development arrangements contemplate some type of initial fee, ongoing fees, and event-triggered fees, like transfer, renewal, and, in some cases, liquidated damages or termination fees. Fee provisions can be one of the more negotiated set of provisions in a multi-unit development agreement, and the actual fees charged from agreement to agreement often vary based on various factors, including the size of the territory, the number of units to be developed, and the responsibilities of the developer.

b. Special Drafting Considerations

i. Master Franchise Agreements

Most master franchise agreements require the master franchisee to pay an initial fee, which can range from the low five figures up to seven figures. The initial master franchise fee is typically not refundable. Various factors contribute to the determination of the initial fee, including the size of the territory, the number of units to be developed, market demographics, and the length of the term of the master franchise agreement.

In jurisdictions where it is permitted, franchisors sometimes require a deposit or holding fee upon the execution of a letter of intent for the master franchise. This fee is intended to ensure that the prospect is serious and to cover the franchisor's transactions costs (or at least a portion of those costs) in the event that the master franchise agreement is not ultimately signed. This fee may be nonrefundable or only partially refundable in the event that the master franchise transaction is not consummated. If the transaction is consummated, the initial fee is often credited by an amount equal to the deposit or holding fee that was actually paid.

Master franchisees are also typically required to pay to the franchisor a portion of the initial franchise fees paid by subfranchisees under each subfranchise agreement, a royalty fee equal to a percentage of the gross sales of each subfranchisee, and a contribution to the advertising fund administered by either the franchisor or the master franchisee. A key drafting point that must be covered in any master franchise agreement is to clearly provide that the franchisor is not responsible for collecting fees from subfranchisees and that the fees required under the master franchise agreement are payable to the franchisor whether or not the master franchisee collects fees payable to it under the subfranchise agreements.

Master franchise agreements should also include “boilerplate” payment provisions, such as electronic funds transfer provisions, provisions requiring the payment of interest on late payments, and audit provisions.

ii. Area Development Agreements

The primary fee payable under an area development agreement is the development fee. The development fee is usually a lump, nonrefundable sum payable upon the execution of the area development agreement. It is generally determined based on the number of units to be developed under the area development agreement. Development fees often act simply as prepayment of all or a part of the initial franchise fees under each unit franchise agreement contemplated by the area development agreement, and the development fee will be credited against the initial franchise fees, pro rata, as the unit franchise agreements are executed. In this case, it is important to include language regarding how and when the credit towards the initial franchise fee will be applied.

Although the operative provisions requiring payment of the initial franchise fees will be contained in the unit franchise agreement, many times area development agreements will state the amount of the initial franchise fee that will be charged under each unit franchise agreement. This is particularly important to ensure that the area developer gets the benefit of the bargain vis-à-vis the initial franchise fees when the area developer is required to sign the “then-current” form of unit franchise agreement for each unit, which could change significantly over the term of the area development agreement.

iii. Area Representative Agreements

Area representatives typically must pay a nonrefundable initial fee in consideration for the grant of the right to act as the franchisor’s area representative in the territory. Since the area representative is not a party to the unit franchise agreements and is not collecting money under the unit franchise agreements, there are generally no ongoing fees paid by the area representative to the franchisor. Instead, franchisors generally pay area representatives a percentage of initial franchise fees and royalties that franchisees in the area representative’s territory pay to the franchisor as compensation for the services provided by the area representative.

In drafting the compensation provisions, franchisors must clearly identify the franchisees for which the area representative will be compensated. For example, if there are existing franchisees in the area representative’s territory, will the area representative service those franchisees, and, if so, will the compensation structure be the same? Will the area representative get the same portion of the initial franchise fee with respect to franchisees that the franchisor initiated discussions with and referred to the area representative? There may also be transition issues that need to be addressed such as the compensation applicable to

franchisees within the territory that are in the sale pipeline at the time the area representative agreement is executed. Also, upon expiration of the term of the area representative agreement, the area representative may be entitled to a “tail” of compensation, particularly for franchise agreements that are signed within the last few years of the term of the area representative agreement. This post-term compensation is generally not applicable if the area representative agreement is terminated for cause.

5. Obligations of Master Franchisee/Developer/Area Representative

a. General

Any multi-unit development agreement will set forth a variety of obligations of the developer, including the core obligation of developing and/or supporting units for which it is responsible, complying with standards, meeting training requirements, complying with sourcing requirements, obtaining and maintaining appropriate levels of insurance coverage, and maintaining records and providing required reports. Certain provisions related to the developers’ obligations (e.g., standards compliance provisions) should be drafted broadly to provide the franchisor and the system with flexibility throughout the term of the multi-unit development agreement. Other provisions (e.g., provisions related to management personnel, financial reporting, and insurance requirements) may need to be drafted with more specificity.

This section is not intended to identify all potential obligations that must be provided for, but, instead discusses drafting considerations related to the core development and support obligations that are included in many multi-unit development agreements.

b. Special Drafting Considerations

i. Master Franchise Agreements

Given that the development of subfranchised units is a fundamental component of any master franchise arrangement, it is axiomatic that master franchise agreements should contain clear provisions relating to the subfranchise agreements offered by the master franchisee. The master franchise agreement should mandate that the form of subfranchise agreement offered and entered into by the master franchisee in the form provided by (or at a minimum, approved by) the franchisor as discussed in Section III.B.1.b.i. above.

Master franchise agreements also should expressly require the master franchisee to meet its obligations (including training and support obligations) under its subfranchise agreements and to enforce the terms of the subfranchise agreements. Even though the franchisor is not a party to the subfranchise agreements, it is important for the master franchise agreement to contemplate that the franchisor will be a third-party beneficiary of the subfranchise agreements (of course, the subfranchise agreement itself will need to include the operative third-party beneficiary provision designating the franchisor as a third-party beneficiary). This gives the franchisor the right to enforce the terms of the subfranchise agreement directly against the subfranchisee, which can be critically important in circumstances in which the master franchisee is not complying with its obligations to enforce terms of the subfranchise agreement (e.g., trademark provisions) and where non-enforcement could result in harm to the franchisor or the system.

The master franchise agreement may contain other obligations, including an obligation to obtain the franchisor's approval of the master franchisee's service program and an obligation to maintain logs of subfranchise sales activities and prospective subfranchisees.

ii. Area Development Agreements

The core obligation in any area development agreement is for the area developer to develop franchised units in accordance with the development schedule (see discussion above regarding development schedules). The area development agreement should set forth specific procedures and requirements for exercising the development rights that the area developer has been granted. Typically, the area developer will be required to sign the then-current form of franchise agreement for each unit within the time periods set forth in the development schedule and then open those units in accordance with the terms and conditions of the franchise agreement and by the deadlines set forth in the development schedule.

iii. Area Representative Agreements

Area representatives' principal pre-sale functions are to identify, recruit, and qualify prospective franchisees that meet the franchisor's standards and qualifications and provide the required franchise disclosure, if any, to prospective franchisees on behalf of the franchisor. Area representatives also may coordinate closings of franchise sales. Importantly, franchisees that the area representative recruits must meet the franchisor's standards.

The area representative agreement should expressly reserve to the franchisor the right to review and approve each proposed franchisee. The area representative should also be prohibited from making any commitment to grant a franchise to prospects until the franchisor has approved the proposed franchisee in writing. Area representatives also are involved in assisting franchisees. The area representative agreement expressly should provide the franchisor with the right to approve any proposed site before the area representative provides any notice of approval to the franchisee or indicates any commitment to approve the site.

The provision of post-sale services to franchisees in its territory is another important function of an area representative. It is important that the area representative agreement contains comprehensive provisions requiring that the area representative provide those services to its franchisees in accordance with the franchisor's standards, which are generally set forth in an area representative manual.

Sample provisions related to core development and support obligations from a master franchise agreement, an area development agreement, and an area representative agreement are included in Attachment 2.

6. Compliance with Laws and Regulatory Requirements

a. General

Most well-drafted franchise agreements (whether multi-unit or single unit) contain general compliance with laws provisions. In multi-unit development agreements where the developer is either selling franchises or is performing the sales function on behalf of the franchisor, these types of provisions take on heightened importance.

b. Special Drafting Considerations

i. Master Franchise Agreements

Master franchise agreements should contain general provisions that require the master franchisee to be in compliance with applicable laws and regulations. Given the fact that the master franchisee is offering subfranchises, there should also be specific provisions regarding the master franchisee's obligations to offer the subfranchises in accordance with applicable franchise laws, including registering with government agencies and providing accurate and timely franchise disclosure to prospective subfranchisees, if required under applicable law or the laws of the territory.

If franchise disclosure is required in jurisdiction(s) included in the master franchisee's territory, the master franchise agreement will often require that the master franchisee prepare a disclosure document contemplating the subfranchise offer at the master franchisee's cost. In that case, the provision should require that the master franchisee engage competent local counsel with experience in franchise matters to prepare the disclosure document and should give the franchisor the opportunity to review the disclosure document (and any changes to it) before its use.

ii. Area Development Agreements

Standard compliance with laws provisions are generally appropriate for area development agreements. Since area developers are not granted the right to offer franchises or engage in franchise sales activities, enhanced compliance with laws provisions addressing those matters are not required.

iii. Area Representative Agreements

Although area representatives should not be given the responsibility for having disclosure documents prepared (that function should be retained by the franchisor since the franchisor will ultimately be the franchisor to the unit franchisees), as noted above, one of the duties of an area representative may be to provide franchise disclosure to prospective franchisees on behalf of the franchisor. Therefore, it is important to provide in the area representative agreement that the area representative must comply with all applicable franchise laws and regulations in the conduct of its sales function. This includes providing disclosure in the proper manner and format and otherwise refraining from prohibited actions, like providing financial performance information to prospects except as permitted by relevant franchise laws and not engaging in misleading or fraudulent acts in the franchise sales process. Area representative agreements should also include requirements that the area representative maintain records related to its franchise sales activities, including logs tracking prospect contacts and to whom (and when) franchise disclosure is provided.

Sample compliance with laws provisions from a master franchise agreement, an area development agreement, and an area representative agreement are included in Attachment 2.

7. Advertising/Promotion/Websites

a. General

To the extent that advertising provisions exist in multi-unit development agreements, they are typically more general than advertising provisions found in unit franchise agreements and relate to development of advertising and sales programs related to the business which is the subject of the multi-unit development arrangement as a whole. Provisions specifically identifying developers' rights (and limitations) to engage in activities on the internet and social media platforms have gained increasing importance as online marketing has continued to grow and franchisors have become more aware of the need to maintain a unified brand voice in cyberspace.

b. Special Drafting Considerations

i. Master Franchise Agreements

Master franchise agreements often contain two general types of advertising/marketing provisions: provisions regarding marketing and sales activities related to the offer and sale of subfranchises and provisions regarding unit level marketing.

The master franchise agreement should provide that it is the master franchisee's responsibility to develop a franchise marketing and sales program as well as procedures for soliciting, evaluating, and qualifying prospective subfranchisees. The master franchise agreement normally will require that those programs and procedures meet the franchisor's standards and that all program materials be accurate and complete. Sometimes, the franchisor will retain the right to approve such programs.

The master franchisee will be responsible for overseeing unit-level consumer marketing by subfranchisees for which it is responsible. At a minimum, the master franchise agreement should require the master franchisee to ensure that all advertising conducted by its subfranchisees be in accordance with the franchisor's standards. Additionally, franchisors should consider whether they want the right to review and approve unit advertising materials used by the master franchisee and its subfranchisees.

Some franchisors adopt a more hands-off approach to unit advertising in the master franchise context, including requiring the master franchisee to develop unit advertising programs and material and monitor unit franchise advertising in its territory. This approach is more conducive to international master franchise relationships where the master franchisee has far more knowledge of the local market. Even under this approach, the franchisor should reserve the right to review advertising programs and materials to confirm that they meet system standards.

ii. Area Development Agreements

Given the limited rights granted under a typical area development agreement, this type of agreement generally does not permit advertising. In fact, most area development agreements do not permit any use of the franchisor's trademarks except in certain limited contexts like site due diligence. Advertising rights and obligations are, instead, addressed in each unit franchise agreement executed pursuant to the area development agreement. Although not necessary if the grant is properly limited, the area development agreement can

include an express prohibition on the use of the trademarks and advertising activities (save for a few isolated exceptions, as noted above).

iii. Area Representative Agreements

Drafting considerations in the context of an area representative agreement are similar to those in the master franchise context. The area representative agreement must address advertising activities related to the core functions of the area representative (i.e., the marketing of the franchise opportunity and the solicitation of prospective franchisees). However, franchisors generally want more control over an area representative's marketing and solicitation activities. This is because, among other things, the franchisor will be a party to the unit franchise agreement and, arguably, it has significantly more lingering exposure to liability resulting from the sales process. Therefore, area representative agreements should include more fulsome controls on the area representative's activities in this area. Those controls may include requiring the area representative to maintain records/logs of all contacts with prospective franchisees (including dissemination of marketing materials) and to provide regular reports to the franchisor summarizing those contacts. The area representative agreement also should address the manner in which the area representative can use internet-based marketing—the simplest approach (and the one that provides the franchisor with the most flexibility) is to provide that the area representative cannot engage in internet marketing without the franchisor's approval.

Sample advertising provisions from a master franchise agreement and an area representative agreement are included in Attachment 2.

8. Confidentiality/Noncompetition Covenants

a. General

Multi-unit developers will have access to confidential information about the system and its operations. In many cases, developers will have a higher level of access to confidential information than unit franchisees. Improper use of confidential information by a significant multi-unit developer potentially could cause great harm to the franchisor and the system. Therefore, confidentiality and noncompetition covenants are a vital part of any multi-unit development agreement. As in any franchise agreement, the draftsman must take great care to ensure that these covenants are as strong as possible without being so overly broad (from a temporal, geographic, or restricted activity standpoint) as to make them unenforceable or subject to modification by a court.

b. Special Drafting Considerations

i. Master Franchise Agreements

Since master franchisees effectively act as the franchisor in their designated territories, to fulfill their duties, master franchisees will need to have virtually unlimited access to confidential information regarding the operation of the franchise system. The confidentiality provisions in a master franchise agreement must reflect this. In addition to prohibiting the master franchisee from disclosing the confidential information in an unauthorized manner, the confidentiality provision should include an acknowledgement by the master franchisee that it is not acquiring any interest in the confidential information (especially the manuals and standards)

and that it will cooperate with the franchisor to enforce the confidentiality obligations of its subfranchisees under their subfranchise agreements.

Additionally, master franchisees may be more likely to develop new concepts or operating methods and techniques since they will be involved at the brand level. However, any new developments related to the system should become the franchisor's property. Therefore, it is important to include in the master franchise agreement a provision under which the master franchisee acknowledges that the franchisor becomes the sole owner of such developments without compensation to the master franchisee (and if the developments do not become the franchisor's property, the master franchisee should waive any rights it has to the developments and the franchisor should be granted an exclusive, royalty-free, worldwide license to use and sublicense the development).

As in most franchise agreements outside of the lodging context, master franchise agreements generally include some form of in-term and post-term noncompetition covenants. These covenants will generally prohibit the master franchisee from operating a "competitive business," which usually includes a business that is similar to the business operated under the subfranchise agreements. These covenants also will prohibit the master franchisee from acting as an area representative, master franchisee, broker, or other type of sales agent for a competitive business. There may also be nonsolicitation components of these provisions under which the master franchisee agrees not to induce its (former) subfranchisees from breaching or terminating their subfranchise agreements or seeking to employ or employing any employees of the franchisor or its developers or franchisees.

ii. Area Development Agreements

Although the confidentiality and noncompetition provisions contained in the unit franchise agreements executed pursuant to the area development agreement are most important and will remain operative long after the expiration of the area development agreement, it remains important to also include these provisions in the area development agreement, since the area developer may be given access to confidential or proprietary information regarding the system in its capacity as an area developer long before a unit franchise agreement is signed. Additionally, the unit franchise agreements may be signed by affiliates of the area developer instead of the area developer entity itself, so the franchisor must ensure that all appropriate parties are bound.

iii. Area Representative Agreements

Area representatives also have access to much of a franchisor's confidential information, including, potentially, strategic plans regarding development of the system. Importantly, the confidentiality obligations of the area representative should extend both to the information regarding the business which is the subject of the franchise that the area representative is promoting and the area representative business itself.

Most area representative agreements also contain some form of in-term and post-term noncompetition covenants. The scope of the restricted activity is often an area that is the subject of negotiation, since some area representatives may wish to act as an area representative for multiple franchise concepts. The area representative agreement should, at a minimum, prohibit the area representative from acting in that capacity for other competing concepts.

Sample confidentiality and noncompetition provisions from a master franchise agreement and an area representative agreement are included in Attachment 2.

9. Indemnification

a. General

A broad indemnity in favor of the franchisor should be a part of every multi-unit development agreement. Generally, the indemnification provision should provide that the franchisor and its affiliates and their respective owners, officers, directors, employees, and agents will be indemnified for damages, losses, costs, and other expenses that they incur due to breaches of the agreement and any acts or omissions of the developer in connection with the establishment or conduct of the business which is the subject of the agreement. The indemnification provision should expressly provide that it survives the termination, expiration, or transfer of the agreement, particularly given the post-agreement relationship inherent in most multi-unit development arrangements.

Obviously, the value of the indemnification is directly related to the developer's financial strength (and, possibly, the strength of the developer's insurance policies), but an indemnification is, nevertheless, an important component of any multi-unit development agreement.

b. Special Drafting Considerations

i. Master Franchise Agreements

If the underlying provisions of the master franchise agreement adequately cover the master franchisee's obligations with respect to subfranchise sales and servicing, the indemnification provision can be relatively simple. It can be drafted to tie back to those operative provisions by stating that the master franchisee will indemnify the franchisor for claims, losses, damages and other expenses resulting directly or indirectly from any breach of a representation, warranty, undertaking, or agreement of the master franchisee under the master franchise agreement. If more specificity is desired, the language can be expanded to include references to the franchisee's subfranchise sales and servicing obligations.

ii. Area Development Agreements

Indemnification provisions in an area development agreement operate in tandem with the indemnification provisions in the unit franchise agreements executed pursuant to the area development agreement. The indemnity in the development agreement applies to the developer's activities under the development agreement, and the indemnity under the franchise agreements cover unit development and operational activities. It is important that the indemnification provisions in each agreement are generally consistent (or at least compliment each other).

iii. Area Representative Agreements

Including an indemnification section (which provides that the area representative will indemnify and reimburse the franchisor for any losses, costs, or liabilities that the franchisor incurs based on the area representative's acts or omissions) in the area representative agreement is critical given that the area representative acts on the franchisor's behalf in the

offer of the franchises and in the provision of post-sale services. Since the franchisor will be solely responsible for preparing the FDD used by the area representative (and the area representative could incur liability for material omissions or misstatements in the FDD), the franchisor may want to consider including a limited indemnity in favor of the area representative, under which the franchisor would indemnify the area representative for losses incurred as a direct result of material omissions or misstatements in the then-current FDD that the area representative provides to prospects.

Sample indemnification provisions from a master franchise agreement, an area development agreement, and an area representative agreement are included in Attachment 2.

10. Transfer

a. General

Multi-unit development agreements should contain provisions stating either that the developer has no right to transfer the agreement or an ownership interest in the developer (if the developer is an entity) or that the developer may transfer only pursuant to clearly-defined conditions. In addition to the proposed transferee needing to be qualified to become the developer, conditions to transfer may include the developer not having been in default; the developer signing a general release; having the transferee sign the then-current form of agreement, which will replace the current agreement; and payment of a transfer fee.

The agreement may also include a right of first refusal in the franchisor's favor under which the developer must offer the franchisor the right to purchase the interest that is the subject of the proposed transfer for the consideration offered by the proposed transferee. If a right of first refusal is included, it should set for the procedures for notifying the franchisor of the offer and for the franchisor to exercise the right of first refusal, including appropriate timeframes.

The agreement should also provide that the franchisor has the right to transfer without prior notice to, or consent from, the developer. The franchisor may wish to provide that it will transfer only to a party that is capable of meeting the franchisor's obligations under the agreement and that the transferee assumes all obligations of the franchisor.

b. Special Drafting Considerations

i. Master Franchise Agreements

The franchisor most often views the individual or entity that is selected as the master franchisee as uniquely positioned to act in the capacity as a master franchisee for a particular market. Given the "personal" nature of the services that the master franchisee will perform, master franchise agreements often provide that the master franchise rights can only be transferred by the master franchisee with the franchisor's prior, written approval, which the franchisor may grant or withhold in the franchisor's sole determination.

This approach gives the franchisor maximum control and comfort that only a fully-qualified party acceptable to the franchisor could assume the obligations of the master franchisee. This level of control is particularly important in the master franchise context, given the broad rights that most master franchisees are granted with respect to the brand. However, some master franchisees (particularly more sophisticated parties) may want the right to bring in additional investors or to transfer the master franchise rights to an affiliated entity without

needing to obtain the franchisor's approval. If the franchisor agrees to such a provision, the master franchisee should be required to meet certain minimum requirements, including providing notice of the transfer and signing documentation that the franchisor reasonably requires to evidence the transfer.

ii. Area Development Agreements

Franchisors generally are less concerned about the transfer of area development rights, since area developers are, in the end, simply multi-unit franchisees and have no upstream control over the brand. For this reason, transfer provisions in area development agreements commonly mirror transfer provisions contained in the unit franchise agreements and will permit the area developer to transfer its development rights to a qualified third party if various conditions are met.

In the area development context, one specified condition must be that the area developer is current on its development schedule. The area developer should not be permitted to assign its development rights if it has failed to develop the required number of units. The franchisor should also consider whether it is acceptable for only the development rights to be transferred or whether all (or a certain number) of the then-effective unit franchise agreements must be assumed by the area developer along with the development rights.

On the other hand, some franchisors believe that area developers should not have the right to transfer development rights at all, reasoning that the area developer should not be able to profit by selling its development rights since the franchisor could have granted the unit franchise rights directly absent the area development agreement and that the area developer does not contribute to the brand solely in its role as an area developer. Though this is generally considered the minority view, some large systems with area development programs follow this practice.

iii. Area Representative Agreements

Because area representatives represent the brand both before and after the franchise sale in a public way, many area representative agreements take the same approach to transfers as is common in master franchise agreements by prohibiting transfers without the franchisor's prior written consent.

Sample transfer provisions from a master franchise agreement, an area development agreement, and an area representative agreement are included in Attachment 2.

11. Termination

a. General

Multi-unit development agreements should contain comprehensive default and termination provisions. Generally, termination provisions set forth defaults for which the agreement can be (i) immediately terminated without notice (e.g., if the developer becomes insolvent, if the developer admits its inability to pay debts, upon foreclosure, or if execution is levied against the developer's property); (ii) terminated upon notice (e.g., the developer makes an unauthorized transfer, the developer violates the confidentiality provisions, the developer commits multiple defaults within a certain period of time, and the developer or its principals are convicted of a felony or other serious crime); and (iii) terminated upon notice and after an

opportunity to cure (e.g., if the developer does not comply with standards or fails to comply with any other provision of the agreement). As in other franchise agreements, unless specifically negotiated, it is not common for multi-unit development agreements to provide the developer with a right to terminate.

Multi-unit development agreements may also contain alternative remedies that the franchisor can exercise in its discretion in lieu of termination of the entire agreement, including reducing the size of the territory granted to the developer, modifying the development schedule, or terminating the development rights but permitting the developer to maintain its operational/servicing rights. Many franchisors prefer the flexibility that the inclusion of these types of alternative remedies provide, particularly in a circumstance where the issues that the developer is experiencing are less serious and/or more limited in nature.

b. Special Drafting Considerations

i. Master Franchise Agreements

As noted above, a master franchisee or its affiliates typically operate one or more unit franchises for the business that is the subject of the master franchise. Master franchise agreements sometimes will contain a one-way cross-default with those unit franchise agreements (i.e., if any of the unit franchise agreements to which the master franchisee or one of its affiliates is a party is terminated, the franchisor has the right to terminate the master franchise agreement).

At first blush this appears to be a harsh remedy. However, vital to the master franchisee's credibility is that it operate its units in accordance with the franchise agreement and system standards, in much the same way that franchisors must ensure that their company-owned units are properly operated. Unit franchise agreements held by the master franchisee or its affiliate do not, however, typically contain cross-default provisions permitting the franchisor to terminate the unit franchise agreement based on a termination of the master franchise agreement.

ii. Area Development Agreements

Since development of franchised units in accordance with the development schedule is the fundamental obligation of an area developer, a specific default based on failure to comply with the development schedule should be provided for in the agreement. Area development agreements may give the franchisor the right to terminate on notice with no opportunity to cure based on a failure to comply with the development schedule (which, of course, does not limit the franchisor's ability to grant some cure period, notwithstanding what the contract provides), or some cure period may be required before the franchisor can terminate.

iii. Area Representative Agreements

Area representative agreements also should provide that a failure to meet development obligations (generally expressed as a number of franchise agreements signed as a result of the area representative's efforts) is a default of the area representative agreement for which the area representative agreement may be terminated. Given some area representatives' involvement in the unit franchise closing process, franchisors may also want to specifically provide that a failure of the area representative to provide the franchisor with signed and dated FDD acknowledgments of receipt and signed franchise agreements is a terminable default.

12. Post-Termination

a. General

Post-termination matters in the area development and area representative contexts are typically relatively straightforward. Standard post-termination provisions will apply (e.g., the developer no longer may conduct the area development/area representative business, must cease use of the trademarks, must pay all amounts due, and must return manuals and other confidential information). The same types of post-termination obligations apply in the master franchise context, but the relationship that master franchisees have with subfranchisees complicates post-termination transition issues in the master franchise context.

b. Special Drafting Considerations

i. Master Franchise Agreements

The respective terms of the master franchisee's subfranchise agreements will almost always continue well past the termination or expiration of the master franchise agreement. The treatment of the master franchisee's relationship with its subfranchisees will differ depending on whether the master franchise agreement expired in accordance with its terms or whether it was terminated based on some default by the master franchisee.

Franchisors may permit the master franchisee to continue to receive fees that it is entitled to following the expiration of the master franchise agreement, provided that the master franchisee continues to meet its service obligations under the subfranchise agreements and certain provisions of the master franchise agreement that survive its expiration (See Term/Renewal discussion above). In that event, the master franchisee would have no further obligation or right to develop units in the territory and no territorial protection.

Alternatively, the franchisor may require the master franchisee to assign all of its subfranchise agreements to the franchisor upon expiration of the master franchise agreement, in which event the master franchisee would not continue to receive fees under the subfranchise agreements.

Most master franchise agreements provide that, upon termination of the master franchise agreement based on a default by the master franchisee, the franchisor will have the right (but not the obligation) to take an assignment of all or certain of the master franchisee's subfranchise agreements, which results in the master franchisee no longer having any relationship with some or all of its subfranchisees. Subfranchise agreements generally have corresponding provisions under which the subfranchisee acknowledges the possibility that the franchisor may assume the obligations of the master franchisee upon termination of the master franchise agreement, or that the subfranchise agreement may be terminated if the master franchise agreement is terminated and the franchisor does not wish to take an assignment of the subfranchise agreement.

ii. Area Development Agreements

Given the limited rights granted under most area development agreements, the post-termination obligations set forth in the area development agreement are generally not

expansive. Minimally, the area development agreement should provide that on termination or expiration the area developer will have no further right to develop units, will comply with confidentiality and post-term noncompetition covenants, and will pay all amounts owed and damages, costs, and expenses to enforce the terms of the area development agreement.

iii. Area Representative Agreements

Since area representatives are granted more rights than area developers, the post-termination obligation in area representative agreements may be more detailed. In addition to the obligations noted above, the post-termination provisions should prohibit the area representative from using the franchisor's trademarks, cancel any assumed names or DBAs that contain the trademarks, and return all manuals, customer/prospect lists, and other system-related material to the franchisor. The franchisor also may wish to include an option to purchase any promotional material related to the area representative business.

Sample post-termination obligation provisions from a master franchise agreement, an area development agreement, and an area representative agreement are included in Attachment 2.

C. Drafting Considerations in the International Context

Most U.S. franchisors that expand outside of the U.S. use their domestic form agreements (to the extent that they have the applicable domestic forms) as a starting point for the documents they use in international markets. If the franchisor implements a different structure internationally (e.g., master franchising), new documents will need to be developed and/or existing documents may need to be significantly modified to address the structural differences, and if the business terms generally offered for international deals will differ from the U.S. business terms, those differences will need to be contemplated as well.

More generally, before using any domestic franchise agreement or related agreement outside the U.S., the document will need to be "internationalized." Provisions that must be added include those that address currency issues and possible government restrictions on payments or exchange controls; an enhanced tax "gross-up" provision; and dispute resolution provisions that take into account the cross-border nature of the transaction. Additionally, other provisions should be examined as they may need to be supplemented or modified. For example, compliance with laws provisions may need to be generalized; trademark provisions should be supplemented to require that the franchisee cooperate with the franchisor with respect to required filings, including executing registered user agreements; advertising fund provisions should address whether the developer and franchisees will be required to contribute to the U.S. advertising fund or whether a separate international or country-specific advertising fund will be created; and the operations manual provisions should state which party is responsible for translation of the manuals to the local language and what conditions apply if the developer is permitted to do so.

Country-specific changes to the agreement may be required in certain jurisdictions as well. The scope and degree of country-specific changes will vary by jurisdiction, but it is critical to have local counsel experienced in franchising review the relevant documents and provide input on required and suggested legal and business changes. Doing so will ensure that the agreements are generally enforceable and that none of the terms of the agreements violate public policy or other statutes or regulations in the country. Local counsel should also provide advice on other matters, including franchise relationship issues (e.g., if franchisors are required

to pay terminated franchisees “indemnities” or other amounts), tax issues implicated by franchise relationships in the country, and issues relating to industry-specific regulation and licensing in the country.

IV. FRANCHISE SALES AND REGULATORY COMPLIANCE ISSUES

A. General Disclosure and Registration Requirements

Franchising as a whole is governed by a complex overlay of federal and state laws that franchisors must comply with regardless of the particular multi-unit development structure they select. The franchise sales process, in particular, is governed by a patchwork of both federal and state laws as compared to franchise “relationship” laws, which, currently, are only found at the state level. These federal and state laws governing the franchise sales process specifies the required content and timing of pre-sale disclosures, including with respect to certain multi-unit development arrangements.

1. Federal

Section 5 of the Federal Trade Commission Act (the “FTC Franchise Rule”) makes it unlawful, in connection with the sale of a franchise, for “any franchisor to fail to furnish a prospective franchisee with a copy of the franchisor’s current disclosure document” and adhere to mandatory waiting periods prior to the prospective franchisee signing or paying any money to the franchisor or its affiliates.² As to the franchisor seeking to award multi-unit development rights to a third-party, multi-unit development arrangements almost always satisfy the definition of a “franchise” in that they involve the franchisor’s (i) collection of an initial fee or payment from the third-party in exchange for the right to do business, (ii) licensing of its trademark to that third-party for use in connection with the licensed business, and (iii) exertion of control over or provision of assistance with respect to the third-party’s business operations.³ Thus, of critical importance to a franchisor’s multi-unit development growth strategy is to what extent the arrangement implicates the disclosure obligations specified by the FTC Franchise Rule.

a. Master Franchise Arrangements

As noted above, a master franchise arrangement clearly falls within the scope of the FTC Franchise Rule in that the definitional elements of a “franchise” are satisfied by the arrangement—i.e., the franchisor typically collects an initial fee from the master franchisee, the master franchisee obtains the right to use the franchisor’s trademark, and the franchisor specifies certain important controls related to the operation of the master franchisee’s business. Accordingly, franchisors seeking to award master franchise rights to a third-party must disclose certain facts related to the master franchise opportunity in an FDD, and in approximately 15 states,⁴ must also file the FDD that contemplates the master franchise offering (or qualify for an exemption) prior to presenting it to a master franchisee candidate.

² 16 C.F.R. § 436.2(a).

³ 16 C.F.R. § 436.1(h). State laws generally adopt this definition, albeit with slight variations. For example, the Minnesota Franchise Act does not focus on whether the franchisor exerts “control” over the franchisee’s business operations, but instead focuses on whether a “community of interest” exists between the parties. See Minn. Stat. § 80C.01, Subd. 4(a)(ii).

⁴ Franchise registration states include California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. Except for Hawaii and Minnesota,

In addition to the above-described disclosure obligations related to the initial franchisor-to-master franchisee sale, the FTC Franchise Rule disclosure obligations are implicated in the subsequent master franchisee-to-subfranchisee sales process. Specifically, the FTC Franchise Rule clarifies that the term “franchisor” means “any person who grants a franchise and participates in the franchise relationship . . . includ[ing] subfranchisors.”⁵ The FTC Franchise Rule goes on to define “subfranchisor” as “a person who functions as a franchisor by engaging in both pre-sale activities and post-sale performance,”⁶ two hallmarks of a master franchise arrangement as previously discussed. Accordingly, to avoid violating the FTC Franchise Rule, a master franchisee must prepare its own FDD related to the franchise offering directed at potential subfranchisees and adhere to the FTC Franchise Rule’s mandatory disclosure and waiting period requirements prior to completing a sale. The North American Securities Administrators Association (“NASAA”) confirmed this approach in its 2008 Franchise Registration and Disclosure Guidelines, by stating affirmatively stating that “[t]he offer of master franchises (subfranchises) is an offer separate from the offer of franchises and usually requires a separate registration or exemption.”⁷

b. Area Development Arrangements

Area development arrangements implicate the FTC Franchise Rule at the franchisor level only. This means that the franchisor must describe the area development offering in the FDD that is provided to the area developer candidate and file the FDD in applicable registration states (as described further below). The area development disclosures are typically included in the franchisor’s FDD that describes the unit franchise offering, i.e., franchisors do not generally prepare an “area developer” FDD separate and apart from the unit FDD. Disclosure obligations are implicated in the franchisor-to-area developer sales process only because in a traditional area development arrangement, the area developer does not function as a franchisor in regards to any pre-sale or post-sale activities; instead, it carries out development obligations as a franchisee either directly or through an affiliated entity by signing individual franchise agreements directly with the franchisor. An updated FDD should be provided to the area developer or its affiliate, as applicable, in connection with the execution of each franchise agreement entered into pursuant to the area development agreement.

c. Area Representative Arrangements

As with master franchise and area development arrangements, a franchisor must prepare an FDD that adequately discloses key facts about its area representative program prior to offering and selling an area representative franchise to prospective candidates. At the federal level, however, no additional disclosure obligation exists when an area representative engages in the franchise sales process with prospective unit franchisees—i.e., the area representative does not need to prepare its own FDD to disclose the unit franchise opportunity for which it is helping the franchisor sell and support. The 2007 amendments to the FTC Franchise Rule clarified that, while the franchisor must disclose its area representative program generally

all franchise registration states exempt certain experienced franchisors (and certain types of transactions) from the registration component of the applicable state’s law. In these states, however, disclosure typically still is required.

⁵ 16 C.F.R. § 436.1(l)(k).

⁶ *Id.*

⁷ North American Securities Administrators Association, Amended and Restated UFOC Guidelines (Feb. 26, 2008).

throughout the FDD (including identifying the area representative as a “franchise seller” on the FDD receipt page), the lack of a direct contractual relationship between the area representative and the unit franchisees that it helps recruit and support excludes the area representative from the definition of a “franchisor” under the FTC Franchise Rule; accordingly, no separate disclosure obligations for the area representative-to-unit franchisee sales process apply.⁸ The franchisor (or the area representative on behalf of the franchisor) must provide an FDD prepared by the franchisor to unit franchisees. As described below in Section VI(A)(2)(b), state treatment of area representative arrangements differ from the FTC Franchise Rule. Franchisors must understand these differences before embarking on an area representative program.

2. State

a. Master Franchise and Area Development Arrangements

State franchise disclosure laws align with the FTC Franchise Rule with respect to master franchise arrangements and area development arrangements. Specifically, with respect to master franchise arrangements, state laws require two sets of disclosures—one set of disclosures related to the franchisor-to-master franchisee opportunity, and the other set of disclosures related to the master franchisee-to-subfranchisee opportunity. Similarly, state disclosure laws compliment the FTC Franchise Rule by requiring only one set of disclosures related to area development arrangements—i.e., disclosures related to the franchisor-to-area developer franchise opportunity.

State law differs from the FTC Franchise Rule by imposing a registration requirement related to both master franchise and area development arrangements. In these states, a franchisor may not engage in the franchise sales process for a master franchise or area development arrangement without first registering the FDD with (or obtaining a registration exemption from) the state regulatory authorities or qualifying for an exemption. Similarly, a master franchisee may not offer and sell subfranchises unless it first registers its own FDD with the state.

b. Area Representative Arrangements

Inconsistent treatment of area representative arrangements and related disclosure obligations abounds at the state level. Despite the lack of contractual privity between an area representative and the unit franchisees that the area representative helps the franchisor recruit and support, area representatives are sometimes treated as “master franchisees” or “subfranchisors” at the state level, and accordingly, require a separate FDD and registration prior to engaging in an area representative-to-unit franchisee sales discussion. This conclusion arises from ambiguous statutory language concerning the term “area franchise” that some states use to define a master franchise (or subfranchise) arrangement.

In a 2009 case that brought this issue to the forefront, *Pinchin et al. v. Nick-N-Willy’s Franchise Pizza Co., LLC*,⁹ the Washington appellate court held that a franchisee was entitled to rescind its franchise agreement with a pizza franchisor because (i) the franchisor’s disclosure document did not disclose its area representative program, and (ii) the area representative that

⁸ Federal Trade Commission’s Amended Franchise Rule FAQ’s, FAQ No. 9, available at <http://www.ftc.gov/bcp/franchise/amended-rule-faqs.shtml>.

⁹ Bus. Franchise Guide (CCH) ¶ 14,179 (Wash. Ct. App. Jul. 22, 2009).

assisted the franchisor in negotiating the sale of the franchise did not provide the franchisee with a separate disclosure document. In reaching this conclusion, the appellate court held that the Washington Franchise Investment Protection Act (“FIPA”) broadly defined a “subfranchisor” to include persons who “grant, sell or negotiate the sale of a franchise.”¹⁰

While the franchisor argued that the area representative was merely a sales person with no authority to grant or sell franchises, the appellate court upheld the lower court’s conclusion that the term “negotiate”—conduct that the franchisor readily admitted the area representative engaged in as part of the limited “sales person” role—was to be broadly construed under FIPA. Thus, the court held that the area representative’s “inability to enter into binding franchise agreements is not critical where the area representative” satisfies the “or negotiate” element of FIPA’s “subfranchisor” definition.¹¹

In a 2010 case against the same franchisor involving an area representative arrangement under FIPA, *Something Sweet, LLC v. Nick-N-Willy’s Franchise Co., LLC*,¹² the court held that dual registrations by the franchisor and area representative were not required because the pizza franchisor’s FDD adequately disclosed the area representative structure to unit franchisees. Because the court concluded that FIPA did not require dual registrations by franchisor and area representative, the appellate court did not analyze whether an area representative would be treated as a “subfranchisor” under Washington law. Thus, the *Pinchin* court’s broad holding that an area representative is akin to a subfranchisor under FIPA still stands.

The *Pinchin* case is troubling in that other state franchise laws reflect a similar approach to defining the term “subfranchisor”—i.e., they define subfranchisor with reference to the word “area franchise,” and then broadly define an “area franchise” to include an arrangement “whereby the subfranchisor is granted the right to sell *or negotiate* the sale of franchises in the name or on behalf of the franchisor.”¹³ In fact, California is the only state to affirmatively adopt the FTC Franchise Rule’s more limited disclosure approach related to area representative arrangements. Specifically, in a February 1, 2008, Commissioner’s Release, the California Department of Corporations adopted the FTC Franchise Rule’s focus on “contractual privity” as the key test for determining whether an area representative must independently prepare and file an FDD with the state prior to engaging in the franchise sales process. The Commissioner’s Release set forth the following common sense guidelines for franchisors to apply when determining if an area representative or other development agent must prepare and file an FDD:

- (1) The analysis of subfranchisor status should emphasize functions performed by the person providing the services, rather than the title assigned to that person.
- (2) Performance of post-sale obligations required by the franchise agreement, without more, does not make a development agent a subfranchisor.

¹⁰ *Id.* at ¶ 14,179.

¹¹ *Id.*

¹² Bus. Franchise Guide (CCH) ¶ 14,398 (Wash. Ct. App. Jun. 1, 2010).

¹³ Haw. Rev. Stat. § 482E-2 (emphasis added). See also 815 Ill. Comp. Stat. 705/3(4)-(5); Md. Code Bus. Reg. § 14-201(c); Mich. Comp. Laws § 445.1502, Sec. 2(6-7); Minn. Stat. § 80C.01, Subd. 7; N.Y. Gen. Bus. Law § 681.6.; N.D. Cent. Code § 51-19-02(2); Wis. Stat. § 553.03(2).

- (3) Persons who are granted the right to receive compensation for referrals to a franchisor or subfranchisor or for receiving compensation for acting as sales agents *are not parties to the franchise agreement*.
- (4) Persons who do not perform post-sale obligations required by the franchise agreement are not subfranchisors.
- (5) To be a subfranchisor, a development agent must have the authority to enter into a franchise agreement; i.e., *be a party to the franchise agreement*, and as a result of entering into the agreement, be obligated to perform franchise obligations.¹⁴

The Commissioner's Release provides helpful clarity on the scope of area representative disclosure and registration obligations under California law, but franchisors nevertheless must closely review other applicable state registration and disclosure laws on this issue prior to launching an area representative program.

3. International Issues

Regardless of the multi-unit development model used to expand internationally, franchisors first must investigate the myriad types of laws and regulations that possibly impact development options and opportunities. Depending on the foreign jurisdiction at issue, franchise-related or other commercial agency laws might apply that govern both the franchise sales process as well as the ongoing relationship, and franchisors must keenly understand both types of laws (and their respective scopes) during the expansion planning stages. Further, many countries treat trademarks and other intellectual property on a "first to file" basis, which means franchisors looking to expand should secure all required registrations very early in the planning stages. Matters related to taxation, transfer pricing, entity formation issues, and local real estate considerations also must be addressed prior to launching internationally.

B. Respective Responsibility for Compliance

Under both federal and state franchise laws, franchisors must disclose material aspects of their franchise offerings to prospective purchasers. This obligation applies whether the franchisor offers a traditional unit-level franchise program, or whether it adopts one of the multi-unit development arrangements discussed above. Master franchisees—and at least arguably in some states, area representatives—must comply with additional obligations related to the offer and sale of the particular franchise opportunity to the end user (i.e., master franchisee-to-subfranchisee sale, or area representative-to-unit franchisee offer negotiation). These additional obligations include the preparation and filing of a separate FDD related to the offer and sale of the unit-level franchise by the master franchisee (or, arguably under some states' laws, area representative). Stiff consequences, including rescission, will apply to a franchisor if either its master franchisee or area representative (as applicable) fails to comply with applicable disclosure and registration laws.

V. CONCLUSION

Entering into an arrangement under which a party is granted the right to develop and/or service multiple units, regardless of its form, is a significant decision for any brand owner. Choosing the right structure and developing appropriate documentation that addresses the

¹⁴ Commissioner's Release 18-F: Franchisors, Subfranchisors and Development Agents, Bus. Franchise Guide (CCH) ¶ 5050.49 (California Dept. of Corporations Feb. 1, 2008). (Emphasis in original.)

issues that are unique to multi-unit development arrangements and is protective of the brand are critical. When structured properly and with the right partner, multi-unit development relationships can result in significant rewards for both the brand owner and the developer.

Attachment 1

Summary of Multi-Unit Arrangement Terminology and Key Hallmarks

Multi-Unit Development Arrangement	Proper Terminology for Parties	Key Relationship Hallmarks	Contracts and Privity
Master Franchise	<p>Master Franchisor (Brand Owner)</p> <p>Master Franchisee or Subfranchisor (Developer)</p> <p>Subfranchisee (Unit Operator)</p>	<p>Master Franchisor delegates substantially all pre-sale and post-sale responsibilities to Master Franchisee in exchange for a portion of the initial and ongoing fees; Master Franchisor retains certain important controls.</p>	<p>Master Franchise Agreement (between Master Franchisor and Master Franchisee)</p> <p>Subfranchise Agreement (between Master Franchisee and Subfranchisee)</p>
Area Representative	<p>Franchisor (Brand Owner)</p> <p>Area Representative or Area Rep (Developer)</p> <p>Franchisee (Unit Operator)</p>	<p>Franchisor delegates some, but not all, pre- and post-sale responsibilities to the Area Rep for Franchisees in a specified territory.</p>	<p>Area Representative Agreement (between Franchisor and Area Rep)</p> <p>Franchise Agreement (between Franchisor and Franchisee)</p>
Area Development	<p>Franchisor (Brand Owner)</p> <p>Area Developer or Developer (Developer)</p> <p>Franchisee (Unit Operator)</p>	<p>Franchisor awards multiple development rights to Area Developer for a territory. Developer (itself or through Franchisee, a controlled affiliate) operates the units.</p>	<p>Area Development Agreement (between Franchisor and Area Developer)</p> <p>Franchise Agreement (Franchisor and Franchisee)</p>

Attachment 2

Sample Provisions from Multi-Unit Development Agreements

A. Grant of Territorial/Exclusivity Provisions (Section III.B.1)

i. Master Franchise Agreement

Provided Master Franchisee is in compliance with this Agreement and all other agreements with Franchisor or any of its Affiliates, Franchisor grants to Master Franchisee: (a) the right, during the Development Term and in accordance with and subject to the terms of this Agreement, to enter into (or cause its Affiliates to enter into) Franchise Agreements with Franchisor for XYZ Stores located in the Territory and to grant Franchises to independent third-party Subfranchisees for XYZ Stores located in the Territory (“Development Rights”); and (b) the right, during the Agreement Term, to maintain its right, title and interest, and all liabilities and obligations, as the subfranchisor of all Subfranchise Agreements entered into during the Development Term, and to use and sublicense the use of the Marks and System in the operation of XYZ Stores in the Territory, all in accordance with and subject to the terms of this Agreement (“Operating Rights”). Master Franchisee may not grant Subfranchises for XYZ Stores located outside the Territory. Master Franchisee acknowledges that the right to operate each Subfranchised Store will be granted pursuant to Subfranchise Agreements (in the form attached hereto as Exhibit []) executed by the Subfranchisees, as the franchisee, and Master Franchisee, as the franchisor, and that the right to operate each Master Franchisee-owned Store will be granted pursuant to Franchise Agreements (in the form attached hereto as Exhibit []) executed by Master Franchisee or its Affiliate, as the franchisee, and Franchisor, as the franchisor.

* * *

Neither Franchisor nor any of its Affiliates will, during the Development Term, grant franchises for the operation of XYZ Stores located in the Territory, nor grant to another person the right to operate or grant franchises for the operation of XYZ Stores located in the Territory, except for: (a) Franchises granted pursuant to this Agreement and (b) stores that Franchisor or any of its Affiliates purchases (or as to which Franchisor or any of its Affiliates purchases the rights as franchisor), that are part of a franchise system or chain, regardless of whether such stores are converted to operate using any of the Marks and/or any or all of the System or whether such stores operate under other trademarks or trade dress and/or use other operating systems.

ii. Area Development Agreement

Pursuant to the terms and conditions of this Agreement and in reliance on the representations and warranties of Developer and its Owners, Franchisor grants to Developer, and Developer accepts, the right and obligation to develop XYZ Stores in the geographic area described in Exhibit [] to this Agreement (the “Territory”). Such development rights shall be exercised in accordance with Article [] of this Agreement and the Development Schedule set forth in Exhibit [] (the “Development Schedule”). This Agreement is not a franchise agreement and does not grant Developer any right or license to operate an XYZ Store or any right to use the Marks. Except as provided in this Agreement and subject to Developer’s full compliance with this Agreement and any other agreement between Developer or its Affiliates and Franchisor or its Affiliates, neither Franchisor nor any Affiliate shall establish, or authorize any

person or entity other than Developer to establish, XYZ Stores in the Territory during the term of this Agreement.

* * *

Developer expressly agrees that Franchisor and its affiliates retain all other rights, including, without limitation, the right (i) to develop and establish other business systems using the Marks, or other names or marks, and to grant licenses to use those systems without providing any rights to Developer, (ii) to advertise and promote the System in the Territory, (iii) to operate, and license others to operate, XYZ Stores under the Marks and the System at any location outside the Territory and in any Reserved Area and (iv) except for the restriction set forth in this Section [] against the establishment of another XYZ Store in the Territory during the term hereof, to engage, directly or indirectly, at wholesale, retail or otherwise, in the production, distribution, license and sale of any goods or services under the Marks, or under other names or marks, within and outside the Territory, through any method of distribution, including, but not limited to, mail order catalogs and the Internet regardless of the proximity to, or the competitive impact on, Developer's operations in the Territory.

iii. Area Representative Agreement

Franchisor hereby grants to Area Representative, upon the terms and conditions herein contained, the right and license, and Area Representative undertakes the obligation, to promote, develop and enhance the XYZ Stores brand and presence in the Territory (as defined below) and to use solely in connection therewith the Marks and the System, as they may be changed, substituted, improved, and further developed from time to time (the "Market Development Rights"). As long as Area Representative is in full compliance with this Agreement and any other agreement between Area Representative and Franchisor or its affiliates, then, except as otherwise expressly provided in this Agreement, neither Franchisor nor its affiliates will authorize any third party to establish an XYZ Store area representative business in the Territory during the term of this Agreement.

Area Representative shall recruit franchise candidates and determine whether such candidates qualify for XYZ Store franchises regardless of where such candidates are located; provided, however, that Area Representative acknowledges that the rights conferred by this Agreement are only for the Territory specified in this Agreement. Area Representative acknowledges that Franchisor and its affiliates and other area representatives may offer XYZ Store franchises to any prospects wherever located. Area Representative shall have no rights to such sales by Franchisor, its affiliates or other area representatives, except that Franchisor, its affiliates and other area representatives will refer to Area Representative such prospects who are located in the Territory and who wish to open a XYZ Store in the Territory.

Except as provided in this Agreement, Area Representative shall not offer, sell, or negotiate the sale of its Market Development Rights to any third party, either in its own name or in the name of Franchisor, or otherwise subfranchise, subcontract, share, divide or partition the Market Development Rights or the Territory. Pursuant to this Agreement, Area Representative will (i) act as the representative of Franchisor in the Territory to identify, qualify, and disclose prospective franchisees to open, develop and operate XYZ Stores in the Territory, and (ii) train, assist, supervise, offer business consultations and otherwise communicate on an ongoing basis with each XYZ Store franchisee in the Territory, in accordance with Franchisor's policies and procedures, as established and amended by Franchisor from time to time.

The territory within which Area Representative shall have the rights described in this Agreement is set forth on Exhibit [] attached hereto and incorporated herein by reference (the "Territory").

The rights granted to Area Representative under this Agreement are nonexclusive, and Franchisor and its affiliates have and retain all rights within and outside the Territory except those expressly granted to Area Representative. Accordingly, Franchisor, its affiliates, and any other authorized person or entity shall have the right, among others, (i) within and outside the Territory to develop and establish other business systems (including systems that distribute products or services similar to those offered at XYZ Stores) using the Marks, or other names or marks, and to grant licenses to use those systems without providing any rights to Area Representative, (ii) to advertise and promote the System and the XYZ Stores in the Territory, (iii) to operate, and license others to operate, XYZ Stores at any location within or outside the Territory, (iv) to license any third parties the right to operate XYZ Store area representative businesses outside the Territory, and (v) except for the restriction set forth in Section [] against the establishment of another XYZ Store area representative business in the Territory during the term hereof, to engage, directly or indirectly, at wholesale, retail or otherwise, in the production, distribution, license and sale of any and all services and products, under the Marks, or under other names or marks, within and outside the Territory, through any method of distribution, regardless of the proximity to, or the competitive impact on, the Territory or Area Representative's business.

During the Initial Term and all Renewal Terms, Area Representative or its affiliate must own, operate and maintain at all times at least one (1) franchised XYZ Store (the "Training Store(s)"). Area Representative must maintain the Training Store as a certified training facility based on the standards Franchisor develops from time to time throughout the term of this Agreement. If at any time, Area Representative's Training Store does not meet Franchisor's certification as a training facility: (i) Area Representative will be in breach of this Agreement; and (ii) Franchisor may cancel, and Area Representative will then forfeit, any compensation that Franchisor otherwise owes Area Representative pursuant to Section [] of this Agreement for any franchisee who Area Representative is not able to train at Area Representative's Training Store.

B. Term/Renewal (Section III.B.2)

i. Master Franchise Agreement

The Development Term expires on the _____ (__) anniversary of the Effective Date. . . . If, upon the expiration of the Development Term, Master Franchisee has complied with this Agreement, Master Franchisee shall have the option to request additional rights to grant Subfranchises ("Additional Development Rights") for _____ (__) additional development term of _____ (__) years (the "Successor Development Term") in accordance with a Development Schedule that Master Franchisee and Franchisor may agree upon by execution of an amendment to this Agreement, as provided below. . . . If, upon expiration of a Development Term, the parties are unable to agree to the terms of a new Development Term, then (a) Master Franchisee shall continue to have its Operating Rights under Section [], including the right to continue to act as subfranchisor with respect to Subfranchise Agreements, duly executed in accordance with this Agreement prior to the expiration of the Development Term and to receive subfranchisor payments pursuant to the Subfranchise Agreements; (b) Master Franchisee shall have no further right to grant any Subfranchise, enter into any Subfranchise Agreement as subfranchisor, or enter into Franchise Agreements with Franchisor; and (c) Franchisor shall have the unrestricted right to operate and franchise XYZ Stores within the Territory, subject to

any territorial protection contained in any effective Franchise Agreement or Subfranchise Agreement.

ii. Area Development Agreement

This term of this Agreement will begin on the Effective Date and, unless sooner terminated, will expire on the earlier of: (i) the date Developer has completed its development obligations under this Agreement, or (ii) 12:00 midnight on the last day specified in the Development Schedule.

* * *

Developer may, at its option, renew its rights under this Agreement for one (1) additional consecutive term, subject to any or all of the following conditions which must, at Franchisor's option, be met prior to and at the time of renewal: (a) Developer shall give Franchisor written notice of Developer's election to renew not less than _____ (__) months nor more than _____ (__) months before the end of the initial term; (b) Developer shall not be in default of any provision of this Agreement, any amendment hereof or successor hereto; neither Developer nor its affiliates shall be in default of any other agreement with Franchisor or any of its affiliates; and Developer and its affiliates shall have substantially and timely complied with the terms and conditions of such agreements during the respective terms thereof; (c) Developer shall have timely satisfied all monetary obligations owed to Franchisor and its affiliates under this Agreement and any other agreement between Developer or any of its affiliates and Franchisor or any of its affiliates; (d) Developer shall execute Franchisor's then-current development agreement, which agreement shall supersede this Agreement in all respects, and the terms of which may differ from the terms of this Agreement, and which renewal development agreement will contain a new development schedule mutually agreed to by Franchisor and Developer; and (e) Developer and its Principals and Franchisor shall execute a mutual general release of any and all claims against each other and their respective affiliates, officers, directors, shareholders, members, partners, [etc.].

iii. Area Representative Agreement

Except as otherwise provided in this Agreement and unless terminated sooner in accordance with the terms and conditions of this Agreement, the term of this Agreement shall be _____ (__) years from the date this Agreement is executed by Franchisor (the "Initial Term").

Area Representative may, after the expiration of the Initial Term of this Agreement, renew this Agreement for _____ (__) additional consecutive terms of _____ (__) years each (each, a "Renewal Term"). If not renewed, this Agreement shall expire and be of no further force and effect except for the duties and rights which expressly by this Agreement survive termination or expiration. Renewal of this Agreement is subject to Franchisor's approval, which shall not be unreasonably withheld. The following conditions must be met prior to the Renewal Term: (a) Area Representative shall give Franchisor written notice of Area Representative's desire to renew not less than _____ (__) months nor more than _____ (__) months prior to the end of the Initial Term and any Renewal Term; (b) Area Representative shall not be in default of any provision of this Agreement, any amendment hereof or successor hereto, or any other agreement between Franchisor or its affiliates and Area Representative or its affiliates and shall have met or exceeded any established Benchmark for sales of franchises; and Area Representative shall have substantially complied with all the terms and conditions of such agreements during the terms thereof; (c) Area Representative shall have satisfied all monetary obligations owed by Area Representative to Franchisor and its

subsidiaries and affiliates, and shall have timely met these obligations throughout the term of this Agreement; (d) Area Representative shall execute Franchisor's then-current form of renewal Area Representative Agreement and any accompanying addenda for the Renewal Term, if any, which agreement shall supersede this Agreement in all respects, and the terms of which, including Area Representative's compensation, may differ from the terms of this Agreement; (e) Area Representative and Franchisor shall agree on a development schedule for the Renewal Term; (f) Area Representative shall execute a general release in a form prescribed by Franchisor, of any and all claims against Franchisor and its subsidiaries and affiliates, and their respective officers, directors, agents, and employees; and (g) if requested by Franchisor, Area Representative shall comply with Franchisor's then-current qualification and training requirements.

C. Development Schedule/Quotas (Section III.B.3)

i. Master Franchise Agreement

Master Franchisee shall continuously exert its best efforts to promote, enhance and fully exploit the business potential of XYZ Stores throughout the Territory. Without limiting the foregoing, Master Franchisee shall have open and operating in the Territory, in accordance with and pursuant to Franchise Agreement(s) and Subfranchise Agreements, the cumulative number of XYZ Stores set forth in Exhibit [] by the corresponding date set forth therein ("Development Schedule"). Time is of the essence with respect to Master Franchisee's obligations under this section, and Franchisor has no obligation under any circumstances to extend the Development Schedule. Master Franchisee's failure to develop and operate XYZ Stores in accordance with the Development Schedule is a breach of this Agreement and upon any such breach Franchisor shall have the right to modify the Development Schedule and/or the Territory in its sole discretion or terminate the Development Rights granted pursuant to this Agreement.

ii. Area Development Agreement

The Development Schedule designates the number of XYZ Stores in the Territory to be established and in operation by Developer upon the expiration of each of the development periods designated therein (the "Development Periods"). Subject to the terms and conditions of this Agreement and with Franchisor's prior written consent, which may be withheld in its sole discretion, Developer may develop more than the total minimum number of XYZ Stores required in any Development Period. Any XYZ Store in excess of the minimum number required to be developed during the Development Period shall be applied to satisfy Developer's development obligation during the next succeeding Development Period, if any. However, Developer shall not open or operate more than the cumulative total number of XYZ Stores Developer is obligated to develop under the Development Schedule. Developer's failure to adhere to the Development Schedule shall constitute a material event of default under this Agreement.

If Developer ceases to operate any XYZ Store during the term of this Agreement, Developer shall develop a replacement XYZ Store within a reasonable time. If Developer transfers its interest in an XYZ Store during the term of this Agreement, then, so long as the XYZ Store continues to operate as an XYZ Store, the transferred XYZ Store shall be counted in determining whether Developer has satisfied the Development Schedule. If the transferred XYZ Store ceases to be operated as an XYZ Store during the term of this Agreement, Developer shall develop a replacement XYZ Store within a reasonable time after the transferred XYZ Store ceases to be operated as an XYZ Store. A "reasonable time" for purposes of this section shall not exceed six (6) months after the date of the applicable occurrence.

iii. Area Representative Agreement

Area Representative shall adhere to the following schedule for opening franchised XYZ Stores in the Territory:

Cumulative Number of Franchised XYZ Stores Open Under Approved Fully-Executed Franchise Agreements	By Date
Yr 1 X	December 31, 20__
Yr 2 X	December 31, 20__
Yr 3 X	December 31, 20__
Yr 4 X	December 31, 20__
Yr 5 X	December 31, 20__

Area Representative shall adhere to this schedule as a condition of maintaining its rights to solicit the sale of XYZ Stores in the Territory. Area Representative must replace any XYZ Store franchise that is terminated or expires or any XYZ Store franchise that otherwise closes so that Area Representative maintains the number of XYZ Store franchises required by the schedule set forth above.

D. Fees/Compensation (Section III.B.4)

i. Master Franchise Agreement

Master Franchisee paid to Franchisor a non-refundable holding fee (“Holding Fee”) in the amount of _____ Dollars (\$_____) upon the execution of the Letter of Intent. Master Franchisee shall pay to Franchisor as a non-refundable master franchise fee (“Master Franchise Fee”) in the aggregate amount of _____ Dollars (\$_____). The _____ Dollars (\$_____) Holding Fee shall be credited toward the Master Franchise Fee upon the execution of this Agreement, and Master Franchisee shall pay to Franchisor the remaining _____ Dollars (\$_____) of the Master Franchise Fee upon the execution of this Agreement.

* * *

For each Franchise Agreement for a Master Franchisee-owned Store signed by Master Franchisee or its Affiliate, Master Franchisee shall pay to Franchisor, as an initial franchise fee, the sum of _____ Dollars (\$_____) pursuant to the terms of each such Franchise Agreement. For each Subfranchise Agreement for a Subfranchised Store entered into by Master Franchisee with a Subfranchisee, Master Franchisee shall pay to Franchisor, as an initial franchise fee, an amount equal to the greater of (i) _____ Dollars (\$_____) or (ii) _____ percent (___%) of the initial franchise fee that Master Franchisee is entitled to receive from the Subfranchisee under the Subfranchise Agreement.

* * *

For each Franchise Agreement for a Master Franchisee-owned Store signed by a Master Franchisee or its Affiliate, Master Franchisee shall pay to Franchisor an ongoing weekly royalty fee in an amount equal to _____ percent (___%) of the Gross Sales of each Master Franchisee-owned Store in accordance with the terms of the Franchise Agreements. For each Subfranchise Agreement for a Subfranchised Store entered into by Master Franchisee with a Subfranchisee, Master Franchisee shall pay Franchisor ongoing weekly royalty fees in an

amount equal to _____ percent (___%) of the Gross Sales of all Subfranchised Stores operating under Subfranchise Agreements granted by Master Franchisee hereunder.

* * *

Royalties and initial franchise fees are payable under this Agreement regardless of whether such royalties and/or initial franchise fees were actually collected from the Subfranchisees.

ii. Area Development Agreement

Upon execution of this Agreement, Developer must pay Franchisor a development fee of _____ Dollars (\$_____), which amount represents a fee of _____ Dollars (\$_____) for each of the _____ (___) XYZ Stores to be developed pursuant to this Agreement. Developer acknowledges and agrees that this fee has been fully earned and is non-refundable, in consideration of administrative and other expenses incurred by Franchisor and for the development opportunities lost or deferred as a result of the rights granted to Developer herein.

Each time that Developer signs a Franchise Agreement pursuant to this Agreement, Franchisor will reduce the initial franchise fee payable under such Franchise Agreement by _____ Dollars (\$_____), provided that at the time the Franchise Agreement is executed, Developer is in full compliance with all of its obligations under this Agreement.

iii. Area Representative Agreement

Upon execution of this Agreement, Area Representative shall pay to Franchisor an initial regional developer fee in an amount equal to _____ Thousand Dollars (\$_____) ("Initial Fee"). The Initial Fee shall be deemed fully earned and nonrefundable upon receipt by Franchisor.

* * *

During the Initial Term of this Agreement, Franchisor shall remit to Area Representative the following portions of payments actually made by franchisees in the Territory to Franchisor, including any payments in connection with franchised XYZ Store owned (in whole or in part) or operated by Area Representative or any affiliate of Area Representative:

TYPE OF FEE	AMOUNT
1. For each Franchise Agreement for a franchised XYZ Store to be located in Area Representative's Territory for which Area Representative is responsible, including Store owned and operated by Area Representative.	_____ percent (___%) of the initial franchise fee that is collected and not refunded.
2. For each Franchise Agreement for a franchised XYZ Store to be located outside Area Representative's Territory for which Area Representative provided the required franchise disclosure document and which Area Representative closed.	_____ percent (___%) of the initial franchise fee that is collected and not refunded.
3. Royalties	_____ percent (___%) of all royalties collected by Franchisor from franchised XYZ Store located within Area Representative's Territory operating under Franchise Agreements signed after the date of this Agreement, including franchised XYZ Stores owned and operated by Area Representative.

Franchisor may require Area Representative to provide certain services to franchisees in Area Representative's Territory that were operating on or before the date of this Agreement ("Existing Franchisees"). If Franchisor requires Area Representative to do so, Franchisor will pay Area Representative compensation in an amount equal to _____ percent (___%) of the royalties collected by Franchisor from such Existing Franchisees.

E. Obligations of Master Franchisee/Developer/Area Representative (Section III.B.5)

i. Master Franchise Agreement

Each Subfranchise shall be evidenced by a Subfranchise Agreement, duly executed by Master Franchisee and the Subfranchisee, in the form of agreement attached to this Agreement as Exhibit [], including all exhibits, ancillary documents and guarantees attached thereto, as amended from time to time to comply with applicable law and to reflect such non-material changes as may be required over time. . . . Master Franchisee may not modify or amend any Subfranchise Agreement for any Subfranchisee in any material respect without first obtaining Franchisor's approval.

* * *

Suggestions for changes to the Subfranchise Agreement may be made by Master Franchisee from time to time, subject to the prior approval of Franchisor. Franchisor agrees to consider such proposed changes in good faith; however, Franchisor shall have sole discretion in approving or disapproving such proposed changes.

* * *

No later than the date upon which the first Subfranchise Agreement is executed pursuant to this Agreement, Master Franchisee shall implement a franchise services program under which Master Franchisee shall be required to provide initial and continuing services and training to Subfranchisees under the Subfranchise Agreements, including without limitation,

establishing an initial training program for Subfranchisees that meets Franchisor's approval, identifying sources of approved equipment, products and supplies, periodic communications with Subfranchisees and periodic inspections of Subfranchisees' XYZ Stores to determine compliance with the Subfranchise Agreements. Such Subfranchisee service procedures shall be subject to the consent of Franchisor. Master Franchisee may modify such procedures from time to time, provided no material modification may be implemented without first obtaining the consent of Franchisor.

* * *

Master Franchisee agrees to use its best efforts to continuously provide the best possible support and assistance to Subfranchisees as required under each Subfranchise Agreement and to enhance the commercial success of XYZ Stores throughout the Territory. All services and assistance provided to Subfranchisees in connection with the operation of XYZ Stores shall be provided by Master Franchisee and such obligation of Master Franchisee shall not be transferred, delegated or subcontracted to any other person or entity without Franchisor's prior approval.

* * *

If Franchisor, in its reasonable judgment, determines that Master Franchisee has not exerted its best efforts and that the failure to comply is material and continues unabated, Franchisor shall have the right to enforce the Subfranchise Agreement and pursue all available remedies, including termination of the Subfranchise Agreement.

ii. Area Development Agreement

Developer must execute a Franchise Agreement for each XYZ Store to be licensed, the form of which will be that which is then being offered by Franchisor to new franchisees for XYZ Stores. The current form of Franchise Agreement is attached as Exhibit [] hereto. Recognizing that time is of the essence, Developer agrees to satisfy the Development Schedule by executing Franchise Agreements within the time frames set forth in the Development Schedule. Failure by Developer to adhere to any date set forth in the Development Schedule will constitute a default under this Agreement, as provided in Section [].

iii. Area Representative Agreement

Area Representative, with assistance from Franchisor, shall identify prospective franchisees for the Territory. Franchisor will, to the extent Franchisor deems advisable, offer counseling and advice in prospective franchisee identification, qualification and selection. Area Representative shall qualify prospective franchisees for the XYZ Stores System and provide such qualifications to Franchisor as it may reasonably request, including but not limited to, a completed franchise application for each prospective franchisee. Thereafter, Franchisor shall approve or disapprove the candidates and at all times retain a right of final approval of any franchisee. Area Representative shall not enter into any franchise agreements with prospective franchisees at any time, and Area Representative shall not make any commitments of any kind to prospective franchisees for a XYZ Store without the express prior written approval of Franchisor. Area Representative covenants and agrees that no legally binding commitment to open a XYZ Store or otherwise shall be consummated without Franchisor's prior written approval. Area Representative understands and acknowledges that Franchisor may reject any proposed franchisee and, if rejected, Area Representative and Franchisor shall continue their efforts to select other franchisees as long as this Agreement remains in effect. An agreement of any kind with any prospective franchisee for a XYZ Store prior to approval by Franchisor shall be at the sole risk and responsibility of Area Representative and shall not obligate Franchisor in any way to accept the prospective franchisee in to the System.

* * *

Area Representative agrees to perform the following services on Franchisor's behalf with respect to Franchisees of XYZ Stores located or to be located in the Territory: (a) Actively, through advertising or otherwise, solicit prospective Franchisees in Area Representative's Territory during the Term of this Agreement (and bear all costs of soliciting prospective Franchisees and developing prospective Franchisees into XYZ Stores operators); (b) provide to Franchisees at Area Representative's Training Store such initial, supplemental and refresher training as Franchisor requires, all in accordance with the timing, content and standards Franchisor periodically prescribes; (c) perform site selection services and provide assistance in lease and sublease negotiations as contemplated by Article [] of this Agreement and supervise the design, construction and build-out for the XYZ Stores in the Territory; at Franchisor's request, locate vendors and coordinate distribution and purchasing programs in the Territory under Franchisor's direction and subject to its right to approve all vendors and programs; (d) provide grand opening support and such pre-opening and post-opening assistance as Franchisor prescribes from time to time for each new XYZ Store; (e) assist Franchisor in its efforts to satisfy all obligations that Franchisor has under, and to enforce all the provisions of, the Franchise Agreements with Franchisees located in the Territory; (f) periodically monitor the operation of the XYZ Stores in the Territory to ensure compliance with the Franchise Agreement and Franchisor's System Standards; (g) conduct on Franchisor's behalf, or assist Franchisor with, inspections or audits of XYZ Stores and their Franchisees as specified by Franchisor from time to time; (h) provide guidance, assistance and logistical support to Franchisor and to its Franchisees with respect to renewal of the Franchises and in connection with transfers of the Franchises or XYZ Stores; and (i) to the extent franchisor participation is permitted or required and in cooperation with Franchisor, participate in and attend all meetings of, any Franchisee associations, Franchisee advisory boards or similar organizations Franchisor approves or that operate in the Territory.

F. Compliance with Laws and Regulatory Requirements (Section III.B.6)

i. Master Franchise Agreement

Master Franchisee shall comply with all applicable law relating to the sublicensing of the Proprietary Marks, the offer and sale of Subfranchise Agreements, and the termination of Subfranchise Agreements, and shall timely obtain at its own cost any and all government approvals and/or registrations necessary for the full and proper conduct of the business contemplated hereunder. Any documents necessary to be prepared to comply with said laws (whether or not filed with governmental authorities), including, without limitation, any and all franchise disclosure documents, shall be prepared by an attorney licensed to practice in the Territory and experienced in representing franchisors and submitted to Franchisor for Franchisor's written approval before Master Franchisee may use such documents and/or submit them to a governmental authority for approval. Master Franchisee shall forward to Franchisor copies of all such government approvals and/or registrations obtained pursuant to this Section within ten (10) days of receipt thereof. If requested by Franchisor, Master Franchisee shall sign and/or obtain the signature of Subfranchisees to such documents as Franchisor may reasonably require in order to give effect to the terms and conditions of this Agreement.

ii. Area Development Agreement

Developer shall comply with all requirements of federal, state and local laws, rules, regulations, and orders. Without limiting the foregoing, Developer certifies that neither Developer nor any of its Owners, employees or anyone associated with Developer is listed in

connection with any Anti-Terrorism Law (as defined in Section []), and Developer agrees not to hire or have any dealings with a person so listed. Developer further certifies that Developer has no knowledge or information that, if generally known, would result in Developer, its Owners, employees, or anyone associated with Developer being so listed. Developer agrees to comply with and/or assist Franchisor to the fullest extent possible in Franchisor's efforts to comply with the Anti-Terrorism Laws and, in connection with such compliance, Developer represents and warrants that none of its property or interests are subject to being "blocked" under any of the Anti-Terrorism Laws and that Developer and its Owners are not otherwise in violation of any of the Anti-Terrorism Laws.

iii. Area Representative Agreement

Area Representative shall comply with all federal, state, and local laws, rules, and regulations, and shall timely obtain any and all permits, certificates, or licenses necessary for the full and proper conduct of the Area Representative Business including, without limitation, licenses to do business, fictitious name registration, sales tax permits and fire clearances.

* * *

Area Representative must comply with all applicable federal and state laws, rules and regulations governing the offering of franchises in the Territory. In this connection, Area Representative must: (a) Furnish to prospective franchisees only documentation Franchisor designates, including the then-current form of franchise disclosure document Franchisor has authorized for use within the Territory, along with such promotional material that Franchisor has previously approved; (b) comply with all requirements for timing of delivery of the franchise documentation and obtaining and delivering to Franchisor the original signed acknowledgment of receipt for each franchise disclosure document Area Representative delivers to any prospective franchisee; (c) make no representations or other statements that conflict with any of the information contained in the franchise disclosure document delivered to the prospective franchisee and within Franchisor's then-current Franchise Agreement; (d) make no financial performance representations, earnings claims, or projections, or provide any information with regard to sales, revenues, income, costs or expenses relating to any franchise or any individual XYZ Store unless in accordance with the provisions of the franchise disclosure document to be provided to prospective franchisees; (e) promptly notify Franchisor of any material information or event which comes to Area Representative's attention that may require disclosure in the franchise disclosure document; and (f) use, display, publish and distribute for purposes of soliciting prospective franchisees, only advertising, marketing and promotional materials that Franchisor has previously approved as acceptable for use in the Territory.

If Area Representative's activities as Franchisor's Area Representative require the preparation, amendment, registration or filing of any franchise documentation or other documents under applicable franchise, business opportunity or related laws, then Area Representative must not solicit prospective franchisees until Franchisor has: (i) registered the XYZ Store franchise offering in the applicable jurisdictions; (ii) provided Area Representative with the documentation necessary for Area Representative to solicit prospective franchisees; and (iii) notified Area Representative that the registration is in effect. Area Representative must stop soliciting prospective franchisees immediately at any time that Franchisor notifies Area Representative that the registration of the franchise is not then in effect or the franchise documentation is not in compliance with applicable law.

Area Representative (and, if necessary, its owners and officers, if any) will register and/or obtain licensure as a franchise broker, real estate broker, business broker or otherwise in any jurisdiction in which Area Representative is required to do so and maintain such

registrations or licenses throughout the Initial Term and any Renewal Term(s), at Area Representative's sole cost and expense. Area Representative must not solicit prospective franchisees until: (i) such registration or license, if necessary, is effective; and (ii) Area Representative has provided to Franchisor documentary proof of its effectiveness.

When providing information to prospective franchisees and in assisting in the closing of any sale of a franchise, Area Representative must only provide Franchisor's then-current form of Franchise Agreement, Development Agreement, and any ancillary documentation that Franchisor has approved for use within the Territory. Area Representative has no authority to make any changes, additions or deletions of any kind to the Franchise Agreement, Development Agreement, or any ancillary documents.

* * *

[For sample provision concerning maintaining records relating to the franchise offering, see the Advertising/Promotion/Websites section, below.]

G. Advertising/Promotion/Websites (Section III.B.7)

i. Master Franchise Agreement

Master Franchisee shall develop a franchise marketing and sales program, which will include procedures to ensure compliance with all applicable laws, preparation of franchise offering and sales materials for dissemination to prospective Subfranchisees, procedures for advertising and soliciting prospective Subfranchisees, procedures for responding to requests for information from prospective Subfranchisees, evaluation and qualification of prospective Subfranchisees, and proper documentation of the grant of Subfranchises. Such marketing and sales program shall be subject to Franchisor's approval, and Master Franchisee shall provide Franchisor with such information relating to Master Franchisee's franchise marketing and sales strategies and activities as Franchisor may request from time to time. Master Franchisee agrees that all materials used in the solicitation of prospective Subfranchisees, and all representations made to prospective Subfranchisees, shall be complete and accurate. Master Franchisee shall be solely responsible for compliance with any and all applicable franchise or similar laws. In order to assist Master Franchisee in developing its franchise marketing strategy, Franchisor shall make available to Master Franchisee those samples of Franchisor's standard franchise sales and marketing materials, which Master Franchisee may adapt for use in the Territory; provided, that all intellectual property rights in and to such adapted materials, including copyright, shall be deemed to be exclusively owned by Franchisor. After obtaining Franchisor's consent, Master Franchisee may implement such approved marketing and sales program and may modify such program from time to time, provided no material modifications may be implemented without obtaining Franchisor's prior consent.

* * *

All advertising by Master Franchisee and by all XYZ Stores subfranchised by Master Franchisee in the Territory shall be completely factual, in good taste (in the judgment of Franchisor), and shall conform to Franchisor's standards. Prior to their use by Master Franchisee or any Subfranchisee, Franchisor may require that samples of advertising, marketing and promotional materials and programs not previously approved by Franchisor be submitted to Franchisor for approval. Master Franchisee shall not use, and shall not permit Subfranchisees to use, any advertising or promotional materials that Franchisor has disapproved or that do not include the copyright notices and trademark notices designated by Franchisor.

ii. Area Representative Agreement

Area Representative is responsible for advertising and for recruiting, soliciting and screening prospects for XYZ Store franchises within the Territory according to the standards, policies and procedures Franchisor develops or approves from time to time. . . . All advertising by Area Representative in any medium shall be conducted in a dignified manner, shall be completely truthful, accurate, and not misleading, shall comply with the highest ethical standards applicable to advertising generally and the Area Representative Business in particular, shall comply with all federal, state, and local laws and regulations and shall conform to such standards and requirements as Franchisor may specify from time to time in writing. Without Franchisor's prior written approval, which Franchisor may give or withhold in its sole discretion, Area Representative may not develop, create, generate, own, or otherwise use any computer and/or electronic media (including but not limited to the Internet, bulletin boards, social networking sites, and news groups) in connection with the Area Representative Business. Area Representative shall not use any advertising or promotional plans or materials unless and until Area Representative has received written approval from Franchisor, which approval shall not be unreasonably withheld. Unless previously approved and not subsequently disapproved by Franchisor, prior to their use, Area Representative shall submit samples of all advertising and promotional plans and materials to Franchisor for approval. If written approval is not received by Area Representative from Franchisor within _____ () days of date of receipt by Franchisor of such samples or materials, Franchisor shall be deemed to have disapproved such samples and/or materials. Area Representative agrees to refrain from any business or advertising practice which may be injurious to the business of Franchisor or the goodwill associated with the Marks and System or other XYZ Stores. Area Representative shall not disseminate or display any advertising or promotional or marketing materials of any kind which have not been provided to Area Representative by Franchisor or approved in writing by Franchisor.

* * *

Area Representative agrees to: maintain written and/or electronic records of all contacts with all prospects for XYZ Store franchises regardless of whether the prospect rises to the level of an Applicant and to provide to Franchisor written progress reports as Franchisor requests from time to time. Area Representative also agrees to assist Applicants in completing the Application and to perform the due diligence, preliminary investigations and evaluations Franchisor specifies from time to time in the Manual or otherwise. Area Representative must promptly submit all Applications for XYZ Store franchises that Area Representative receives to Franchisor along with all information Franchisor requires regarding the Applicant. Area Representative must maintain copies of the Applications and related information with Area Representative's records. Franchisor may inspect Area Representative's records regarding XYZ Store franchise Applicants and Applications at any time, with or without notice.

H. Confidentiality/Noncompetition Covenants (Section III.B.8)

i. Master Franchise Agreement

Confidentiality: Master Franchisee acknowledges that the Manual contains Confidential Information and that all materials that Master Franchisee receives from Franchisor, or that are owned by Franchisor, that are marked confidential will be treated as part of the Confidential Information. The Confidential Information is proprietary and includes trade secrets of Franchisor. During and after the Agreement Term, Master Franchisee: (1) shall not acquire any interest in the Confidential Information; (2) shall not use the Confidential Information in any other business or capacity; (3) shall maintain the absolute confidentiality of the Confidential

Information; (4) shall not make unauthorized copies of, or extracts from, any portion of the Confidential Information disclosed in any form whatsoever; and (5) shall adopt and implement all reasonable procedures prescribed from time to time by Franchisor to prevent unauthorized use or disclosure thereof by directors, officers and employees of Master Franchisee including restrictions on disclosure of Confidential Information to and the use of nondisclosure agreements with such persons. Nothing herein shall limit or restrict Master Franchisee from providing the Manuals and other information regarding the development and operation of XYZ Stores, some of which may be Confidential Information, to Subfranchisees under valid Subfranchise Agreements in connection with the development and operation of XYZ Stores pursuant to the terms and conditions thereof.

* * *

Master Franchisee agrees to disclose, and to cause its Affiliates and Subfranchisees to disclose, to Franchisor all ideas, concepts, methods, techniques and products relating to the development, marketing and/or operation of XYZ Stores conceived or developed by Master Franchisee or any of its Affiliates or Subfranchisee ("Information"). If incorporated into the System, such Information shall, to the fullest extent permitted by applicable law, become the sole and exclusive property of Franchisor, and Franchisor shall have the exclusive and worldwide right to incorporate same in the System for use in all XYZ Stores operated by Franchisor, its Affiliates and their respective franchisees. Franchisor shall have no obligation to make any payment to Master Franchisee or any Affiliate or Subfranchisee with respect to any Information developed or suggested by Master Franchisee or by an Affiliate or Subfranchisee and incorporated by Franchisor in the System. To the extent any intellectual property rights in and to any Information cannot automatically become the sole and exclusive property of the Franchisor due to applicable law, Master Franchisee shall and shall cause its Affiliate or Subfranchisee to grant to Franchisor an exclusive, royalty-free, transferable, irrevocable, worldwide license (with rights to sublicense through multiple tiers of sublicensees) to practice such non-assignable rights, including, but not limited to, the right to use, reproduce, distribute and modify any Information. To the extent any of the rights in and to the Information can neither be assigned nor licensed by to Franchisor, the Master Franchisee, its Affiliate and Subfranchisees irrevocably waive and agree never to assert such non-assignable and non-licensable rights against Franchisor, its Affiliates, any of Franchisor's successors in interest, or any of Franchisor's customers. No rights of any kind in or to the Information are reserved to or by the Franchisor or shall revert to or be reserved by or on behalf of the Franchisor.

* * *

Noncompetition: During the Agreement Term, neither Master Franchisee nor any of its Owners may: (a) directly or indirectly (such as through a member of his or their Immediate Families) own any legal or beneficial interest in, or render services or give advice to (1) any Competitive Business or any entity which grants franchises, licenses, or other interests to others to operate any Competitive Business located anywhere in any other country, state, or geographic area in which Franchisor has used, sought registration of, or registered the Marks or similar marks or operates or licenses others to operate a business under the Marks or similar marks; or (b) divert or attempt to divert any business or customer of XYZ Stores to any competitor by inducement or otherwise, or do anything injurious or prejudicial to the goodwill associated with the Marks or the System.

* * *

Upon any termination of this Agreement or upon expiration of the Agreement Term or if this Agreement is transferred by Master Franchisee or any Owner of Master Franchisee, neither Master Franchisee nor any of its Owners shall for a period of two (2) years, or to the fullest extent permitted under applicable law, commencing on the effective date of such termination, expiration or transfer: (a) have any direct or indirect interest (through a member of the immediate family of an Owner of Master Franchisee or otherwise) as a disclosed or beneficial

owner in any Competitive Business located or operating anywhere in the Territory; (b) perform services or give advice as a director, officer, manager, employee, consultant, representative, agent, or otherwise for any Competitive Business located or operating anywhere in the Territory; (c) directly or indirectly induce, or seek to induce, any Subfranchisee to modify, rescind, terminate or breach its Subfranchise Agreement assigned to Franchisor as per the provisions of Section []; or (d) directly or indirectly employ, or seek to employ, any person who is employed by any developer or franchisee of Franchisor or any of its Affiliates, nor induce nor attempt to induce any such person to leave his or her employment, without prior written consent of Franchisor and such person's employer. Master Franchisee and its Owners expressly acknowledge that they possess skills and abilities of a general nature and have other opportunities for exploiting such skills, so that enforcement of the foregoing covenants will not deprive them of their ability to earn a living.

ii. Area Representative Agreement

Confidentiality: Area Representative shall not, during the term of this Agreement or at any time thereafter, communicate, divulge, or use for Area Representative's benefit outside the System or for the benefit of any other person, persons, partnership, association, or corporation any confidential information, knowledge, or know-how including, without limitation, standards, procedures, product information, specifications and the methods of operation of XYZ Stores or the Area Representative Business contemplated hereunder which may be communicated to Area Representative, or of which Area Representative may be apprised, by virtue of Area Representative's operation under the terms of this Agreement or Area Representative's, or its affiliate's, operation of a franchised XYZ Store. Area Representative shall divulge such confidential information only to those employees who must have access to such confidential information in order to operate the Area Representative Business and who have executed covenants as required by this Agreement.

* * *

At Franchisor's request, Area Representative shall require any or all of Area Representative's managers and personnel who may have access to confidential information to execute covenants that they will maintain the confidentiality of information they receive in connection with their employment by Area Representative in the Area Representative Business. Such covenants shall be in a form satisfactory to Franchisor, which may include, without limitation, specific identification of Franchisor as a third party beneficiary of such covenants with the independent right to enforce them.

* * *

Noncompetition: Area Representative specifically acknowledges that, pursuant to this Agreement, Area Representative will receive valuable specialized training and confidential information including, without limitation, information relating to the operational, sales, promotional, and marketing methods and techniques of Franchisor and the System. Accordingly, Area Representative covenants that during the term of this Agreement, except as otherwise approved in writing by Franchisor, Area Representative shall not, either directly or indirectly, for itself, or through, on behalf of, or in conjunction with any person, persons, partnership, corporation or limited liability company: (a) divert or attempt to divert any business or customer of the business franchised hereunder to any competitor by direct or indirect inducement or otherwise, or do or perform, directly or indirectly, any other act injurious or prejudicial to the goodwill associated with Franchisor's Marks, other marks proprietary to Franchisor and the System; (b) employ or seek to employ any person who is at that time employed by Franchisor, an affiliate of Franchisor, or by any other franchisee of Franchisor, or otherwise directly or indirectly induce such person to leave his or her employment; (c) own, maintain, advise, help, invest in, make loans to, be employed by, engage in, or have any direct

or indirect interest in any business which is similar to the Area Representative Business or to the XYZ Store business, including, without limitation, any business that offers for sale goods or services which are similar to those distributed to or offered at an XYZ Store and which is located within the United States, its territories or commonwealths, or any other country, province, state or geographic area in which Franchisor has used, sought registration of or registered the Marks or similar marks or operates or licenses others to operate a business under the Marks or similar mark; or (d) divert or attempt to divert, by direct inducement or otherwise, to the Area Representative Business any active customer account of Franchisor or another franchisee of Franchisor without the prior consent of Franchisor.

Except as otherwise approved in writing by Franchisor, for a continuous uninterrupted period of time commencing upon the expiration or termination of this Agreement, and continuing for two (2) years thereafter, regardless of the cause for termination and regardless of which party terminates this Agreement, Area Representative or any officers, directors or shareholders of Area Representative shall not, either directly or indirectly, for itself, or through, on behalf of, or in conjunction with any person, persons, partnership, corporation, or limited liability company own, maintain, advise, help, invest in, make loans to, be employed by, engage in, or have any interest in any business which is similar to the Area Representative Business or to the XYZ Store business, including, without limitation, any business that offers for sale goods or services the same as or similar to those distributed to or offered at an XYZ Store which is located within the Territory or within a _____ (__) mile radius of any XYZ Store which is owned by Franchisor, an affiliate of Franchisor or a franchisee of Franchisor.

I. Indemnification (Section III.B.9)

i. Master Franchise Agreement

Franchisor shall not be liable for any damages, including damages to property or for personal injury or death, directly or indirectly arising out of the operation of Master Franchisee's business conducted pursuant to this Agreement, whether or not caused by Master Franchisee's negligent or willful action or failure to act. Master Franchisee agrees to defend and hold Franchisor, its Affiliates and their respective shareholders, directors, officers, employees, agents and assignees harmless against and to reimburse them for: (a) all claims, losses, obligations and damages directly or indirectly arising out of any breach of any representation, warranty or agreement of Master Franchisee hereunder; and (b) all claims, losses, obligations and damages directly or indirectly arising out of the operation of Master Franchisee's business conducted pursuant to this Agreement, including, without limitation, those alleged to be caused by Franchisor's negligence, as well as the costs, including attorneys' fees, of defending against them. Notwithstanding the foregoing, this indemnity shall not apply to any liability arising from Franchisor's gross negligence or willful misconduct, except to the extent that joint liability is involved, in which event the indemnification provided herein shall extend to any finding of comparative or contributory negligence attributable to Master Franchisee, its Owners, officers, directors, employees, independent contractors, or Affiliates. For purposes of this indemnification, "claims" shall mean and include all obligations, actual and consequential damages and costs reasonably incurred in the defense of any such claim against Franchisor, including without limitation reasonable legal fees and related travel and living expenses. Franchisor shall have the right to defend or settle any such claim against it in such manner as Franchisor deems appropriate or desirable in its sole discretion. This indemnity shall continue in full force and effect subsequent to and notwithstanding the expiration or termination of this Agreement.

ii. Area Development Agreement

Developer must indemnify and hold Franchisor and Franchisor's affiliates, and their respective officers, directors, employees, and agents harmless against any and all claims, obligations, and damages arising directly or indirectly from, as a result of, or in connection with Developer's establishment of any XYZ Stores, the business conducted under this Agreement, or Developer's breach of this Agreement, including, without limitation, those alleged to be caused by Developer's negligence. In the event Franchisor incurs any costs or expenses, including, without limitation, legal fees, travel expenses, and other charges, in connection with any proceeding involving Developer in which Franchisor is not a party, Developer must reimburse Franchisor for all such costs and expenses promptly upon presentation of invoices. Developer acknowledges and agrees that its indemnification and hold harmless obligations under this Section will survive the termination or expiration of this Agreement.

iii. Area Representative Agreement

Area Representative hereby agrees to indemnify and save Franchisor, its affiliates, and its and their respective owners, directors, officers, employees, and agents ("Indemnified Parties") harmless from and reimburse the Indemnitees for any and all liabilities, losses, suits, claims, demands, costs, fines, taxes (excluding taxes based on Franchisor's income), losses (including legal fees and costs) and actions of any kind or nature whatsoever to which they shall or may become liable for or suffer by reason of: (i) infringement, alleged infringement, or any other violation or alleged violation by Area Representative or any affiliate of any patent, mark or copyright or other proprietary right owned or controlled by third parties, unless such violation or infringement relates to the use of the Marks or other proprietary information as to which a license has been granted hereunder and such use has been in accordance with this Agreement; (ii) the violation, breach or asserted violation or breach by Area Representative or any affiliate of any federal, state or local law, regulation, ruling, standard or directive or any industry standard; (iii) libel, slander or any other form of defamation of Franchisor, the System, or any franchisee, developer, or area representative operating under the System, by Area Representative or by any affiliate; (iv) the violation or breach by Area Representative or by any affiliate of any warranty, representation, agreement or obligation in this Agreement or in any other agreement with Franchisor or any of its affiliates; and (v) acts, errors, or omissions of Area Representative or any of its affiliates and the respective officers, directors, shareholders, partners, members, agents, representatives, independent contractors servants and employees of any of them in connection with the establishment and operation of the Area Representative Business, including, but not limited to, any acts, errors or omissions of any of the foregoing in the operation of any motor vehicle. Under no circumstances will Franchisor or any other Indemnified Party be required to seek recovery from any insurer or other third party, or otherwise to mitigate its, their or Area Representative's losses and expenses, in order to maintain and recover fully a claim against Area Representative. Area Representative agrees that a failure to pursue such recovery or mitigate a loss will in no way reduce or alter the amounts Franchisor or another Indemnified Party may recover from Area Representative. The terms of this Section [] shall survive the termination, expiration or transfer of this Agreement or any interest herein.

Franchisor shall hold Area Representative harmless from and against any material omissions or misstatements in any then-current franchise disclosure document it prepares for use by Area Representative in the Territory.

J. Transfer (Section III.B.10)

i. Master Franchise Agreement

The rights and duties created by this Agreement are personal to Master Franchisee and to the Owners of Master Franchisee. Accordingly, neither Master Franchisee nor any Owner, nor any successor or assign of Master Franchisee or any Owner, shall sell, assign, transfer, convey, give away, pledge, mortgage or otherwise dispose of or encumber any direct or indirect interest in this Agreement or in Master Franchisee without the prior written consent of Franchisor, which Franchisor may withhold in its sole discretion. Any purported assignment or transfer, by operation of law or otherwise, made in violation of this Agreement shall be null and void and shall constitute a material breach under this Agreement. If Master Franchisee wishes to transfer all or part of its interest in this Agreement, or if Master Franchisee or an Owner wishes to transfer any ownership interest in Master Franchisee, transferor and the proposed transferee shall apply to Franchisor for its consent.

ii. Area Development Agreement

Developer understands and acknowledges that the rights and duties set forth in this Agreement are personal to Developer, and that Franchisor has granted such rights in reliance on the business skill, financial capacity and personal character of Developer and Developer's Principals. Accordingly, neither Developer nor any Principal, nor any successor or assign of Developer or any Principal, shall sell, assign, transfer, convey, give away, pledge, mortgage or otherwise dispose of or encumber any direct or indirect interest in this Agreement (including, without limitation, any or all of Developer's rights or obligations hereunder), the business operated under this Agreement, or in Developer without the prior written consent of Franchisor. Any purported assignment or transfer, by operation of law or otherwise, made in violation of this Agreement shall be null and void and shall constitute a material breach of this Agreement.

If Developer wishes to transfer all or part of its interest in this Agreement or in the business operated hereunder, or if Developer or a Principal wishes to transfer any interest in Developer, transferor and the proposed transferee shall apply to Franchisor for its consent. Franchisor shall not unreasonably withhold its consent to a transfer of any interest in Developer, in this Agreement or in the business operated hereunder but Franchisor may, in its sole discretion, require any or all of the following as conditions of its approval to any such transfer:

(a) All the accrued monetary obligations of Developer and its affiliates and all other outstanding obligations to Franchisor and its affiliates arising under this Agreement or any Franchise Agreement or other agreement shall have been satisfied in a timely manner and Developer shall have satisfied all trade accounts and other debts, of whatever nature or kind, in a timely manner;

(b) Developer and its affiliates shall not be in default of any provision of this Agreement, any amendment hereof or successor hereto, or any Franchise Agreement or other agreement between Developer or any of its affiliates and Franchisor or any of its affiliates; and Developer shall have substantially and timely complied with all the terms and conditions of such agreements during the terms thereof;

(c) The transferor and its principals (if applicable) shall have executed a general release, in a form satisfactory to Franchisor, of any and all claims, against Franchisor,

its affiliates, and the officers, directors, shareholders, partners, members, agents, representatives, independent contractors, servants and employees of each of them;

(d) The transferee shall enter into a written agreement, satisfactory to Franchisor, assuming full, unconditional, joint and several, liability for and agreeing to perform from the date of the transfer, all obligations, covenants and agreements of Developer in this Agreement; and, if transferee is a corporation, partnership or limited liability company, such of transferee's principals as Franchisor may designate as principals shall execute such agreement as transferee's principals, and guarantee the performance of all such obligations, covenants and agreements;

(e) The transferee shall execute the standard form development agreement then being offered to new System developers or a revised form of this Agreement, as Franchisor deems appropriate, and such other ancillary agreements as Franchisor may require, which agreements shall supersede this Agreement and its ancillary documents in all respects and the terms of which agreements may differ from the terms of this Agreement, and if the transferee is a corporation, partnership, or limited liability company, such of transferee's principals as Franchisor may designate shall execute such agreement and guarantee the performance thereof;

(f) The transferee shall demonstrate to Franchisor's satisfaction that transferee meets the criteria considered by Franchisor when reviewing a prospective developer's application for development rights;

(g) The transferor shall remain liable for all of the obligations to Franchisor in connection with this Agreement incurred prior to the effective date of the transfer and shall execute any and all instruments reasonably requested by Franchisor to evidence such liability;

(h) Developer shall pay Franchisor a transfer fee in an amount equal to _____;

iii. Area Representative Agreement

Franchisor has appointed Area Representative, and Area Representative has accepted the appointment, as Franchisor's exclusive Area Representative in the Territory during the Term of this Agreement. Accordingly, Area Representative agrees that Area Representative may not transfer or assign this Agreement or all or any part of its rights or obligations under this Agreement to any other person or entity without Area Representative's prior written consent, which Franchisor may withhold in its sole discretion.

K. Post-Termination (Section III.B.12)

i. Master Franchise Agreement

Upon any termination or expiration of the Agreement Term, Franchisor shall have the right upon notice to Master Franchisee to have any and all right, title and interest of Master Franchisee in Subfranchise Agreements revert to Franchisor. Upon such notice, all rights of Master Franchisee under this Agreement will immediately terminate; and Master Franchisee will have the following duties which survive the expiration or termination of this Agreement:

(a) As to the Subfranchise Agreements, upon the expiration or termination of the Operating Rights hereunder, Master Franchisee will promptly assign to Franchisor or Franchisor's designee all of the Subfranchise Agreements accepted for assignment by Franchisor (in Franchisor's sole discretion), and will execute and require all Subfranchisees to execute all documents reasonably required by Franchisor in connection with such assignment. Master Franchisee hereby appoints Franchisor its true and lawful agent and attorney-in-fact with full power and authority for the sole purpose of taking such action as is necessary to complete such assignments. Master Franchisee agrees that this power of attorney shall continue in full effect regardless of the termination or expiration of this Agreement. Master Franchisee agrees to execute any and all further documents or instruments as Franchisor shall require in order to give full legal effect to the foregoing power of attorney; and

(b) Master Franchisee shall indemnify, defend and hold Franchisor, its Affiliates and their respective shareholders, directors, officers, employees, agents and assignees harmless against and shall reimburse them for all damages directly or indirectly arising from a Subfranchisee claim under Subfranchise Agreements arising or accruing before Franchisor's exercise of its right to act as subfranchisor or grantor under the Subfranchise Agreements. Franchisor shall be entitled to any and all files, documents and data relating to the System, Subfranchisees and the development, marketing and operation of XYZ Stores in the Territory. Master Franchisee agrees to preserve and make available for Franchisor, at Master Franchisee's principal offices, all such documents and data and to fully cooperate with Franchisor.

ii. Area Development Agreement

Upon the termination or expiration of this Agreement, Developer shall have no right to establish or operate any XYZ Store for which a Franchise Agreement has not been executed by Franchisor and delivered to Developer at the time of termination or expiration (but may complete development of and/or operate XYZ Stores under then-existing Franchise Agreements) and Franchisor may develop, or authorize others to develop, XYZ Stores in the Territory. Upon the expiration or termination of this Agreement:

(a) Developer and the Owners shall comply with the restrictions on Confidential Information contained in Section [] and the covenants against competition contained in Section []. Any other person who has executed or who was required to execute similar covenants pursuant to Section [] shall also comply with such covenants.

(b) Developer and the Owners shall promptly pay all sums owing to Franchisor and its subsidiaries or Affiliates. Such sums shall include all damages, costs and expenses, including reasonable attorneys' fees, incurred by Franchisor as a result of any default by Developer, which obligation shall give rise to and remain, until paid in full, a lien in favor of Franchisor against any and all of the personal property, furnishings, equipment, signs, fixtures, and inventory owned by Developer and on the premises operated under any Franchise Agreement at the time of default.

(c) Developer and the Owners shall pay to Franchisor all damages, costs and expenses, including reasonable attorneys' fees, incurred by Franchisor in connection with obtaining any remedy available to Franchisor for any violation of this Agreement and subsequent to the termination or expiration of this Agreement in obtaining injunctive or other relief for the enforcement of any provisions of this Section [].

iii. Area Representative Agreement

Upon termination or expiration of this Agreement in its entirety, regardless of which party terminates this Agreement, all rights granted hereunder to Area Representative shall forthwith terminate and be of no further force and effect and:

(a) Area Representative shall immediately cease to represent to the public or hold itself out as a present or former Area Representative of Franchisor, including without limitation, immediately ceasing the recruiting and solicitation of franchisees for the Franchisor System.

(b) Area Representative shall immediately and permanently cease to use, by advertising or in any other manner whatsoever, any confidential methods, procedures, and techniques used in or associated with the System and immediately and permanently cease to use the Marks including, without limitation, the mark "XYZ" and all other distinctive forms, slogans, signs, symbols, or devices associated with the System; provided, however, that this Section [] shall not apply to the operation by Area Representative of any Spas under the System, pursuant to a franchise agreement between Franchisor and Area Representative which is then in effect.

(c) Area Representative shall take such action as may be necessary to cancel any assumed name or equivalent registration which contains the name "XYZ" or any other service mark or trademark of Franchisor, and Area Representative shall furnish Franchisor with evidence satisfactory to Franchisor of compliance with this obligation within thirty (30) days after termination or expiration of this Agreement; provided, however, that this Section [] shall not apply to the operation by Area Representative of any Spas under the System, pursuant to a franchise agreement between Franchisor and Area Representative which is then in effect.

(d) Area Representative shall promptly pay all sums owing to Franchisor and its affiliates. In the event of termination for any default of Area Representative, such sums shall include all damages, costs, and expenses, including reasonable attorneys' fees, incurred by Franchisor as a result of the default, which obligation shall give rise to and remain, until paid in full, a lien in favor of Franchisor against any and all of the personal property, equipment, inventory, and fixtures owned by Area Representative and on all premises operated hereunder at the time of default.

(e) Area Representative shall immediately turn over to Franchisor all manuals (including the Manual), franchise disclosure documents, agreements, prospect and customer lists, records, files, instructions, correspondence and all other materials related to the operation of the Area Representative Business and all copies thereof (all of which are acknowledged to be Franchisor's property); provided, however, that this Section [] shall not apply to the operation by Area Representative of any Spas under the System, pursuant to a franchise agreement between Franchisor and Area Representative which is then in effect.

(f) Franchisor shall have the option, to be exercised within thirty (30) days after termination or expiration, to purchase from Area Representative any or all promotional materials owned by Area Representative, at Area Representative's cost based on the invoices received by Area Representative for the materials.

(g) All covenants, obligations, and agreements of Area Representative which by their terms or by reasonable implication are to be performed, in whole or in

part, after the termination or expiration of this Agreement, shall survive such termination or expiration.

WILL K. WOODS

Will K. Woods is a partner in the Franchise and Distribution Group in the Dallas office of Baker Botts L.L.P. He concentrates his practice in franchise and distribution law. He counsels clients on structuring international and domestic franchise transactions, distribution of products and services, and franchise registration and disclosure matters. Mr. Woods represents franchisors throughout their business life cycle: in the start-up stage; as middle-market franchisors; and as mature, global franchisors.

He represents many of the leading hotel, lodging and hospitality franchise companies and has vast experience in negotiating complex franchise transactions both in the U.S. and in many other countries around the world and in counseling clients across industries with respect to system restructuring and related relationship issues.

Mr. Woods is a frequent author and speaker on franchise and distribution related topics. His publications include *Good News on State Taxation of Out-of-State Franchisors in New Mexico . . . Or Not*, Franchise Law Journal (Winter 2007); *Item 19 Earnings Claims: A Disclosure Most Franchisors Should Try to Make*, Franchise Law Journal (Spring 2001); *Hot Topics in Franchising and Hospitality*, Hospitality Law Conference, February 2009; and *U.S. Business Opportunity Laws and Their Effect on Franchisors*, Franchise and Distribution, August 2009. He is currently editing the second edition of the Forum on Franchising book, *Fundamentals of International Franchising*.

Mr. Woods is an active member of various trade and bar associations, including the International Franchise Association and the ABA Forum on Franchising. He has been listed in Chambers USA (Franchising), has been named in Franchise Times' "Legal Eagles" as one of the top 101 franchise lawyers in the US and Canada, has been listed in the International Who's Who of Franchise Lawyers, was named a Rising Star by Law and Politics, and has been named one of the Best Lawyers in Dallas by D Magazine.

He was the ABA Young Lawyers Division Liaison to the Forum on Franchising from 2005 to 2007 and is currently on the Governing Committee of the Forum on Franchising.

Mr. Woods received his BBA from Baylor University in 1994 and his JD, *cum laude*, from Baylor University School of Law in 1998. He is a member of the Texas Bar.

SARAH YATCHAK

Sarah J. Yatchak is a Senior Attorney with Buffalo Wild Wings, Inc. in Minneapolis, Minnesota, where she manages a variety of franchise, advertising and marketing, trademark and general commercial matters for the company. Prior to joining Buffalo Wild Wings, Sarah practiced transactional franchise and distribution law with Faegre & Benson LLP in the firm's Minneapolis office, where she counseled numerous franchisor clients with respect to the development, growth and overall management of their respective franchise systems. Sarah's background also includes several years of franchise litigation experience, thus affording her clients with the benefit of a well-rounded perspective. In addition to authoring several articles for the Franchise Law Journal, Sarah has served as a Topic & Articles Editor for the Franchise Law Journal since September 2008. She is a past speaker at both ABA and IFA events, as well as CLEs for state and local bar associations.