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INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW

INTERNATIONAL FRANCHISING

Examination of the answers to the questionnaire prepared by the Committee on International Franchising of the International Bar Association in consultation with Unidroit

(Secretariat memorandum)

Rome, May 1993

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INTRODUCTION

Unidroit first began to examine the possibility of working on franchising in 1985 when, following a proposal from its Canadian member, the Governing Council of the Institute requested the Secretariat to draw up a preliminary report with a view to deciding whether franchising should be included in the Work Programme of the Institute. This preliminary study was presented to the Governing Council at its 65th session.(1)

At the request of the Governing Council this report, together with a questionnaire designed to elicit further information, was submitted to Governments, professional circles and recognised experts in the field. At its 67th session the Governing Council was seized of a survey of the answers to the questionnaire.(2)

In view of the answers received and of the developments expected both nationally and internationally, particularly the envisaged adoption of the (then) draft Regulation of the EEC Commission, the Governing Council decided to postpone any decision on future work on franchising contracts. The Secretariat was asked to submit a paper to the 68th session of the Council, which would primarily examine the actual terms used in franchising agreements.

The Governing Council was duly seized of a report examining the terms of the franchise agreements received,(3) following an examination of which it decided that franchising should remain on the Work Programme, and that the Secretariat should continue collecting documentation and follow developments in the field.

At the time, the work carried out by Unidroit examining the feasibility and the need for uniform regulation of international franchising contracts in particular met with widely differing reactions from the franchising community. While a positive response came from lawyers mainly from civil law jurisdictions, lawyers from common law countries expressed the view that there was no need for any specific regulation of franchise agreements. They stressed that the United States' experience of such regulation had been negative and that this had in fact brought about a move towards deregulation. Furthermore, this move to deregulation, which was not limited to the United States, had led to the Australian Franchise Agreements Bill being withdrawn.(4) The fear was also expressed that a regulation of the phenomenon would increase litigation instead of limiting it.

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(1) See document C.D. 65 - Doc. 12, also published as Study LXVIII - Doc. 1, UNIDROIT 1986.

(2) See C.D. 67 - Doc. 9, also published as Study LXVIII - Doc. 2, UNIDROIT 1988.

(3) See C.D. 68 - Doc. 11, also published as Study LXVIII - Doc. 3, UNIDROIT 1989.

(4) Subsequently the Australian Minister for Small Business and Customs appointed a *Franchising Task Force* to examine and propose mechanisms for the reduction of barriers and

Consequently, the *Committee on International Franchising* of the International Bar Association's Section on Business Law (Committee X), which brings together the major franchise lawyers of the world, suggested an alternative to the elaboration of an international uniform instrument, namely the preparation of a guide to franchise agreements and their terms, which they saw as an initiative which would be of real use to the franchising community. They proposed that this guide be prepared jointly by Unidroit and Committee X.

The reactions of the Unidroit Governing Council to this proposal were largely favourable, although the Council considered that the possibility of preparing a convention or uniform law was not to be ruled out *a priori*.

Following further talks between the Unidroit Secretariat and Committee X, it was proposed that the guide should deal with master franchise agreements, which are those through which international franchising is conducted in a majority of cases, and that a questionnaire dealing with these agreements and designed to elicit the information to be dealt with in the guide should be prepared. This questionnaire should then be sent out primarily to members of Committee X, but also to experts with which Unidroit was in touch.

At its 70th session in May 1991 the Governing Council of Unidroit decided to endorse the questionnaire which, it was felt, would also provide a sound basis on which to proceed for the further examination of those aspects of franchise agreements which might lend themselves to treatment at an international level. The Governing Council further requested the Secretariat to present a document analysing the possible areas most amenable to treatment at international level.

The questionnaire was sent out to correspondents in 41 different countries. After an initially quick response from nine correspondents the arrival of the replies slowed down. At

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impediments to the efficiency and growth of the franchising sector. The report of the Task Force was published in December 1991. It recommended the development of a self-regulatory Code of Practice (See *Report by the Franchising Task Force To the Minister for Small Business and Customs The Hon. David Beddall M.P.,* December 1991, Recommendation 6). The Code was released on 1 February 1993. It is voluntary and self-regulatory, meaning that franchisors and others who are regulated by the Code can choose whether or not to comply with it. The Code of Practice will apply to franchisors (including sub-franchisors), franchisees, service providers (including banking and financial institutions that provide franchise-related financial support to franchisors and franchisees and publishers or advertising media providers who accept work and publish advertising for the purpose of selling or promoting franchise systems) and advisers (i.e. persons, firms or associations such as lawyers, accountants, marketing or management consultants, and business brokers who provide advise to franchisors and franchisees) and State Small Business Corporations. The Code provides for and regulates prior disclosure, the certification by franchisees of receipt of the disclosure document, of a *Guide for Franchisees* and of a copy of the Code of Practice, cooling off periods for franchisees within which they may terminate the franchise agreement, unconscionable conduct, alternate dispute resolution, and the requirement that the franchisee be identified as as being a franchisee.

the time of writing (May 1993) 19 answers have been received, although several more have been announced. Annexed to this report is the questionnaire sent out (Annex I) and a list of the countries covered by the survey with an indication of the countries from which answers have been received (Annex II).

The analysis of the areas most amenable to treatment at international level was presented to the Governing Council in June 1992 in document Study LXVIII - Doc. 5.

It should perhaps be recalled that there are basically four different ways to franchise internationally: directly; through a branch or subsidiary; through master franchise agreements and through joint venture agreements.(5)

In direct franchising the franchisor himself grants franchises to individual franchisees in the foreign country. In this case there is an international contract to which the franchisor and franchisee are parties. Problems associated with direct franchising in an international context include the difficulty of franchisors to control the performance of the franchisees, and the difficulty of franchisors to provide franchisees with the assistance they need both before they open the outlet (e.g. site selection and the feasibility studies which precede this selection, contacts with local suppliers, etc.), and for the whole duration of the contract. Franchise formulas often have to be adapted when they are transplanted into another country, and unless the countries are culturally, and perhaps geographically, close to each other, franchisors may have problems bridging the cultural gap between the two countries, which involves differences in language, habits, tastes and laws. Other problems include choice of law and jurisdiction, intellectual and industrial property rights, taxation (e.g. withholding taxes) and the exportation of profits, currency restrictions, import restrictions and/or quotas, etc. Direct franchising is, however, quite rare in the international context.

The second possibility is when the franchisor establishes a subsidiary or branch office in the foreign country. This subsidiary or branch office will then act as franchisor for the purpose of granting franchises. An advantage of this approach is that the franchisor is present in the foreign country as a corporate body. The contract will in this case be a domestic contract subject to the local legislation. The franchisor will have to rely on local personnel to a very great extent, also to avoid having to transfer too many of the personnel it has at home to the foreign subsidiary: this would involve problems associated with the obtaining of work permits for these employees and the application of the local labour laws to them, in addition to the disadvantage of depriving the business at home of experienced personnel. Otherwise the problems associated with this way of franchising internationally are similar to those associated with direct franchising.

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(5) On international franchising, see A. KONIGSBERG, *International Franchising*, Ardsley-on-Hudson (NY)/Washington, 1991; M. MENDELSOHN, *How to Franchise Internationally*, London 1989; and M. ABELL (ed.), *The International Franchise Option*, London 1990.

As indicated above, the method which is used the most is that of a master franchise agreement. In this case the franchisor grants a local partner, the sub-franchisor, the exclusive right within a certain territory (such as a country) to open franchise outlets itself and/or to grant franchises to sub-franchisees. The sub-franchisor in other words acts as franchisor in the foreign country. In this case there are two agreements involved: an international agreement between the franchisor and the sub-franchisor, and a national franchise agreement between the sub-franchisor and the sub-franchisees. There are in this case no direct relations between the franchisor and the sub-franchisees. The advantages of a master franchise arrangement include the fact that the local sub-franchisor will be familiar with the habits, tastes, culture and laws of its country, that it will know its way about the local bureaucracy and will know where to turn for what. On the other hand, the financial return of the franchisor will be reduced as the sub-franchisor will be receiving a share. Furthermore, the franchisor will have to rely on the sub-franchisor to control the performance of the sub-franchisees, as there is no direct relationship between them. Similarly, the sub-franchisees will have to rely on the sub-franchisor for anything which concerns the franchise. Several problems may arise with this type of arrangement. These include the fate of the sub-franchise agreement if the master franchise agreement is terminated. According to one view the sub-franchise agreement would terminate automatically, in which case the problem of the sub-franchisee being able to obtain compensation, and from whom, arises. Similarly, if a new sub-franchisor is appointed who also has the right to grant franchises, and therefore also to grant exclusive territorial rights to other sub-franchisees, the question arises of the position of the sub-franchisees of the first sub-franchisor, and of the possibilities they would have to continue to enjoy, at least for a certain period of time, the exclusive territorial rights granted them by the terminated sub-franchisor. The situation as regards liability, for example for defective products, also has to be considered, as do questions relating to intellectual and industrial property rights - can the sub-franchisees as well as the sub-franchisor be granted the right to use the intellectual and industrial property of the franchisor? Is it for example possible to have a registered user in the country concerned? The labour law aspects examined above would also have to be considered. The problems indicated under the direct franchising option are clearly also to be considered in relation to master franchise agreements.

The fourth way to franchise internationally is by means of joint ventures. What normally happens in these cases is that the franchisor and a local partner create a joint venture; this joint venture then enters into a master franchise agreement with the franchisor, and proceeds to open franchise outlets and to grant sub-franchises just as a normal sub-franchisor would do. An arrangement such as this will have to consider legislation on joint ventures in addition to all the other legislation which needs to be taken into account. It should be noted that this double link with the franchisor may create conflicts of interest for the franchisor. Joint venture franchises may nevertheless be one

way of solving the problem of financing franchise operations in countries where financial means are scarce.

The great number of areas which franchise agreements in general touch upon was confirmed in the analysis of the areas most amenable to treatment at international level, to wit: general contract law; commercial law; agency law and the law regulating other distribution contracts; leasing; securities; financial investments; intellectual and industrial property law; competition law, including also fair trade practices laws; corporate law; taxation; ordinary property law; legislation on consumer protection and products liability; insurance law; labour law; the law regulating the transfer of technology; legislation regulating foreign investments; currency control regulations; import restrictions and/or quotas; taxation. In view of the fact that the areas franchise agreements touch upon are areas where national, and at times even international, regulation already exists, it was considered to be doubtful whether it would be realistic to consider adopting uniform legislation for such highly regulated areas.

It was instead felt that what should be stressed was the importance of disclosure, i.e. of the franchisor providing adequate prior information to permit a prospective franchisee to decide whether or not to enter into a franchise relationship, even if admittedly this was an aspect which had been considered mostly, if not exclusively, in relation to domestic franchise relationships. It was recalled that the majority of cases dealing with franchising in the United States dealt with misrepresentation, in particular in relation to the prospects for development of the business, to the effective size of the investment necessary and to the income that the franchisee might expect. The importance attached to this prior information was confirmed also by German and French cases, which had provided for an obligation on the part of the franchisor to compensate the franchisee in cases of misrepresentation.(6) It was further submitted that disclosure was an area which lends itself to the adoption of uniform standards at international level as it would appear to be possible to arrive at a consensus on what information is necessary for a prospective franchisee to arrive at a reasoned decision on whether or not to enter into the franchise relationship in as full a consciousness as is possible of the risks involved and of the implications of the relationship.

A second area identified was one often considered to be suitable for international regulation, i.e. choice of law and jurisdiction. The fact that franchisors had been known to impose their own law as the law applicable to the contract to the detriment of the franchisee had often been seen as an abuse which would require regulation at

(6) See OLG München, decision of 13.11.1987 - 8 U 2207/87, in *BB* 1988, p. 865; *Cour d'appel de Colmar*, 9 March 1990 in *Recueil Dalloz Sirey* 1990, *Jurisprudence*, p. 232, with the comment by J.-J. BURST.

international level.[7] It was however observed that international cases relating to this point had not as yet come to court, and that as the experience and awareness of franchisors increased clauses like these increasingly gave way to clauses providing for arbitration. It was submitted that the role played by existing international conventions, such as the *1968 Brussels and 1988 Lugano Civil Jurisdiction and Judgments Conventions* and the *1980 Rome Convention on the Law Applicable to Contractual Obligations*, as well as that of international instruments relating to international arbitration, should be considered in greater detail in relation to international franchise agreements. It was submitted that in view of the existence of, and the area covered by, international instruments any consideration of choice of law and jurisdiction as areas to be covered by an international instrument on franchising would have to be carefully circumscribed so as to be effective and useful.

A third area worth considering in the context of a possible regulation of international franchising was identified as that of the tripartite relationship of master franchise agreements, particularly in relation to the problems which arise in connection with their termination (the fate of sub-franchise agreements, questions of ownership of the good will of the clients, the possibility of compensation for any loss suffered in connection with the termination of the agreement, etc.).

The conclusion reached in the examination conducted was therefore that the area most amenable to treatment at international level was that of disclosure. Furthermore, questions relating to the tripartite nature of master franchise agreements, in particular to their termination, as well as questions of choice of law and jurisdiction, should be considered.

Duly seized of these conclusions, the Governing Council decided to postpone taking a final decision on the future work of the Institute on this topic until it had considered the information on the areas suggested for treatment which would be forthcoming in the answers to the questionnaire prepared by the IBA in consultation with Unidroit and endorsed by the Institute following the decision of the Governing Council to this effect.

This document will examine the answers to the questionnaire in relation to disclosure, choice of law and jurisdiction, the termination of master franchise agreements and the effects of this termination, as well as to other problems arising as a result of the tripartite nature of master franchise agreements.

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(7) The experience of the United States in this respect has been analysed by G.F. CARPINELLO, in his article *Testing the Limits of Choice of Law Clauses: Franchise Contracts as a Case Study*, in *Marquette Law Review*, Vol. 74, 1990, p. 57 ff.

I. DISCLOSURE

Paradoxically, the area which was found to be the one most amenable to treatment at international level was the one dealt with least in the questionnaire. The questionnaire was in fact designed to elicit the information which a practical legal guide to the drawing up of master franchise agreements should include and not to consider the need for regulation of the information which a prospective franchisee might need, and could be considered to have a right to, in making a reasoned decision as to whether or not to enter into a franchise agreement. The questionnaire therefore did not consider disclosure other than in relation to the disclosure of trade mark licences or of registered users of trade marks, which clearly is only one aspect of this item which might be of use to a prospective franchisee in assessing the rights he or she might have in the operation of a business conducted under the trade mark, trade name or service mark of a franchisor. From the survey conducted it emerged that whereas in a majority of the countries considered there is no requirement for the registration of licences or of registered users of a trade mark, there is such a need in some common law countries such as the United Kingdom and to a certain extent Canada.

In general, when one speaks of disclosure one refers to information on all those aspects of the franchise in question which a prospective franchisee might need when evaluating the possibility of entering into a franchise agreement.

It is clearly very important where prospective franchisees in a domestic situation are concerned, but its importance when one considers the situation of sub-franchisors in international franchising, many of which are large companies, is disputed.

One view is that if disclosure is important for a prospective franchisee in a normal domestic relationship, it is even more so in international franchising, the reason being the increased difficulty for a prospective sub-franchisor in a foreign country to acquire the information needed to evaluate the solidity of the franchisor, both financially and as regards its relations with other sub-franchisors or (sub-)franchisees, and therefore to make a realistic evaluation of the franchise. Such difficulties might lead to misjudgments on the part of the sub-franchisor which will inevitably reflect on the sub-franchisees. If a sub-franchisor suddenly finds that it cannot furnish the assistance needed by the sub-franchisees this can lead to a break-down of the system and to the consequent bankruptcy of all concerned. The difficulties inherent in an international situation clearly also relate to the possibility a sub-franchisor or franchisee might have in proceeding against a franchisor located in a foreign country. It might on the other hand also be argued that having specific provisions on disclosure in fact protects the franchisor who cannot be held liable for the lack of success of the franchisees or of the sub-franchisor if it is able to show that all the relevant information had been disclosed to the sub-franchisor or franchisee prior to their concluding the agreement.

The contrary argument is that the sub-franchisor is experienced in business and makes a business decision: a franchisor who makes a decision of this importance without having adequate information would be rash in the extreme. It is a calculated risk which the prospective sub-franchisor takes and protection such as that which might be required for domestic franchisees, often seen as small family-owned enterprises, is therefore not necessary and might even hamper the development of cross-border franchising.

In any event, one should also consider whether it is appropriate for the same rules to apply to sub-franchisors and to sub-franchisees, whether the same information need necessarily be passed first from franchisor to sub-franchisor and then from sub-franchisor to sub-franchisee, or whether it might not be more appropriate to allow for certain differences, at least as regards the amount of detail of the information given.

If the conclusion is reached that some form of regulation of disclosure is required, either only for franchisees or also for sub-franchisors, then the type of information required by existing domestic instruments might be considered to be the most useful. Clearly the degree of detail must be considered, as a franchisor has an undeniably legitimate interest in keeping certain information confidential, as do other types of business. On the other hand, prospective sub-franchisors and/or sub-franchisees must be given the possibility of properly evaluating the prospects of the business they are interested in entering into and of guarding themselves to the greatest extent possible against fraud: they must in other words have the means to take action if they come up against fraudulent behaviour on the part of franchisors. This would include being able to take appropriate action in the case of misrepresentation, which might not always fulfil the requirements of law as regards fraud. A balance must therefore be achieved between the interests of the franchisor and the interests of prospective sub-franchisors and/or sub-franchisees.

As is well-known only three countries have legislation on franchising (the United States, Canada (the Province of Alberta) and France) and consequently only these have specific rules on what information a franchisor must offer a prospective franchisee.

In the case of the *United States,* legislation regulating franchising, or certain aspects of it, in particular disclosure and registration, is to be found both at federal and at state level.(8)

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(8) A valuable source of information regarding legislation on or affecting franchising in 24 different countries of the world is the *Survey of Foreign Laws and Regulations Affecting International Franchising* prepared by the Franchising Committee of the American Bar Association Section of Antitrust Law, 2nd ed., 1989. As regards the United States, the Commerce Clearing House (CCH) publish the *Business Franchise Guide*, a loose-leaf service containing the text of both federal and state legislation, decisions by US courts and reports.

At federal level the *United States Federal Trade Commission* in 1979 adopted a trade regulation rule on franchising entitled *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures*.[(9)] This Rule requires franchisors to provide prospective franchisees with a document with detailed information regarding: the franchisor; the directors and executive officers of the franchisor; litigation and bankruptcy histories; the franchise to be purchased; initial and recurring payments; obligations to purchase; financing; required personal participation; termination, cancellation and renewal provisions and statistics on the number of franchisees; training; site selection; and financial reporting, including audited financial statements.[(10)]

In March 1993 three bills were introduced into Congress, the first being a bill for a *Federal Franchise Disclosure and Consumer Protection Act*[(11)] which is intended to codify the Federal Trade Commission disclosure rule, which would add mandatory disclosures of operating data relating to sales, costs and earnings, would prohibit fraud in franchise sales and furnish a private civil action for injunctive relief and damages. The second is a bill for a *Federal Fair Franchise Practices Act*[(12)] which would prohibit termination without good cause, advance notice and an opportunity to cure a claimed default. It would impose a fiduciary duty on franchisors that undertake financial or accounting functions for franchisees, it would require franchisors to exercise commonly recognised skill and knowledge in operating a franchise system, would bar encroachment within a reasonable proximity of an established franchise and would provide a private civil action for injunctive relief and damages. The third bill is for a *Federal Franchise Data and Public Information Act*[(13)] which would require the U.S. Department of Commerce to collect and publish data from franchise disclosure documents filed with the department by franchisors. It would also require the Census Bureau to analyse statistical data on franchises as part of its five-year business survey.

Furthermore, the *North American Securities Administrators Association (NASAA)*[(14)] has also adopted a *Uniform Franchise Offering Circular* which indicates what information should be furnished to prospective franchisees. The format prescribed varies from that in the FTC Rule, but the substance is essentially the same. The FTC permits the use of the UFOC as an alternative to the basic document it has prescribed in its Rule. The UFOC has been accepted for use, with minor modifications, in all states which regulate the offer and

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(9) 16 C.F.R. § 436.

(10) See P. ZEIDMAN, *United States*, p. 2, in *Survey of Foreign Laws and Regulations Affecting International Franchising, cit.* For the text of the FTC Rule and interpretative guides thereto, see CCH, *Business Franchise Guide*, at ¶ 6080 ff.

(11) H.R. 1315. The text of this as well as of the other two bills is published in CCH, *Business Franchise Guide*, Report number 159, Extra Edition, of 24 March 1993.

(12) H.R. 1316.

(13) H.R. 1317.

(14) For the text of the Uniform Franchise Offering Circular, see CCH, *Business Franchise Guide*, at ¶ 5750. The North American Securities Administrators Association includes among its members both US state and Canadian provincial administrators.

sale of franchises by registration and/or disclosure.[15] A Discussion Draft for proposed revisions of the Offering Circular was issued for public comment in July 1992. These proposed revisions include a proposal to require disclosure of information concerning franchisor-owned-and-operated outlets as well as franchises, and disclosure of the addresses and telephone numbers of every franchisee that ceased to do business during the 12 months preceding the end of the most recent fiscal year.

In August 1990 the NASAA adopted a *Model Franchise Act* to be offered to states and provinces for enactment. The Model Act requires franchisors to provide a disclosure document containing detailed information as above, and in addition requires state administrative agencies to review and approve the disclosure information and other information prior to all franchise offerings.[16]

In addition to these instruments at a federal level, fifteen states have enacted laws requiring pre-sale disclosure to prospective franchisees, and thirteen of these also require registration or approval of state authorities prior to the offer or sale of a franchise.[17] The details of what is required to be disclosed may vary, but are always along the lines of what is required by the Federal Trade Commission.

In *Canada* only the province of Alberta has legislation on franchising.[18] The *Alberta Franchises Act* was recently revised by the Alberta Securities Commission Board.[19] The Government has, however, put the proposed amendments on hold pending reexamination and has requested the Canadian Franchise Association to examine the proposal. As regards the specific point of disclosure, the amendments proposed would expand the number of acceptable disclosure documents. A certain flexibility would be allowed as to the form of the disclosure document so as to provide for the use of either the Uniform Franchise Offering Circular format or the Federal Trade Commission disclosure document. This flexibility would extend also to the use of forms of disclosure documents that may be developed by industry associations. Furthermore, amendments have been proposed which would exempt franchisors (which the proposal calls "franchise grantors") from the filing of disclosure documents, the delivery of disclosure documents, the registration of salespersons and the giving of disclosure documents to prospective franchisees ("franchise operators") in certain situation.[20]

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[15] P. ZEIDMAN, *United States*, p. 2, in *Survey of Foreign Laws and Regulations Affecting International Franchising, cit.*

[16] *Report from America* by P. ZEIDMAN/A. LOEWINGER/J. GILBERT, in *The Journal of International Franchising and Distribution Law*, 1991, p. 147 f.

[17] P. ZEIDMAN, *United States*, p. 4, in *Survey of Foreign Laws and Regulations Affecting International Franchising, cit.* A selection of laws regulating franchising is to be found reproduced in Study LXVIII - Doc 4.

[18] *The Franchises Act, Revised Statutes of Alberta (1980 C.F-17), as amended.* The text of the Alberta Franchises Act is reproduced in CCH, *Business Franchise Guide*, at ¶ 7010 ff.

[19] 1992 Bill 45, Franchises Act, Legislative Assembly of Alberta.

[20] See Part 5, Exemptions, of the Act.

Mexico has provided for a certain regulation of franchising in its law on industrial property.(21) It requires pre-sale disclosure of information to prospective franchisees.

In Europe, the only country with legislation relating to franchising is *France*: on 31 December 1989 *Law No. 89-1008, concerning the development of commercial and artisanal enterprises and the improvement of their economic, legal and social environment*(22) was adopted, the first article of which is of relevance to franchising. It is strictly a disclosure law, the details of which were subsequently laid down in Government *Decree No. 91-337 of 4 April 1991*.(23) In accordance with this decree the information to be furnished to prospective franchisees should include information on the history of the enterprise, on its legal constitution, on the intellectual property concerned, financial statements for the two preceding years, lists of other franchisees in the chain, information on the franchise agreement, such as the duration of the contract, conditions for renewal, for termination and assignment of the contract, as well as on any exclusivities. The document must further indicate the nature and the amount of expenses and investments specific to the shop sign or trade mark which the prospective franchisee will face before beginning operation.

The disclosure which is required under the *Australian Code of Practice* includes information on the type of business offered in the franchise, on the length and experience of the franchisor in operating or offering the franchise or other franchises, on the experience of the franchisor's principal and directors, on the assets and liabilities and tangible assets and liabilities of the franchisor, on material legal proceedings concerning the franchisor or its principals. Furthermore, a summary of the main particulars of the franchise system and agreements must be offered, as must indications regarding the number of existing franchises and company-owned outlets and written projections of achievable levels of potential sales, income, gross and net profits from the particular franchise concerned. Interestingly, details of the financial performance of any relevant business operations have to be given only if the franchisor has not been in the franchised business for more than two years.

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(21) *Law on Industrial Property*, published in the *Diario Oficial*, 27 June 1991, effective as of 28 June 1991. The relevant sections of this law are reproduced in the CCH, *Business Franchise Guide*, at ¶ 7210, in an English translation by CCH staff and the Monterrey Office of the law firm of Brownstein Zeidman and Schomer, Washington, D.C. See also Study LXVIII - Doc. 4.

(22) *Loi n° 89-1008 du 31 décembre 1989 relative au développement des entreprises commerciales et artisanales et à l'amélioration de leur environnement économique, juridique et social*, published in the *Journal Officiel* of 2 January 1990. The original text of the law is reproduced in Study LXVIII - Doc. 4.

(23) *Décret n° 91-337 du 4 avril 1991 portant application de l'article 1er de la loi n° 89-1008 du 31 décembre 1989 relative au développement des entreprises commerciales et artisanales et à l'amélioration de leur environnement économique, juridique et social*, published in the *Journal Officiel* of 6 April 1991. The original text of the decree is reproduced in Study LXVIII - Doc. 4.

As can be seen from the above, the type of information which a franchisor is required to disclose is substantially the same in the countries which have regulated this aspect in one form or another. It is the degree of detail and the emphasis which changes, not the essential content of the obligation. These national instruments may therefore be used as a source of inspiration for a prospective international instrument, a careful evaluation being then made of which aspects should be covered and in how much detail.

II. CHOICE OF LAW AND JURISDICTION

A whole section of the questionnaire was dedicated to questions of choice of law and forum, covering issues such as the willingness of courts in the countries considered to accept the choice of law made by the parties, which law is in general that chosen, how the courts are likely to proceed in the application of a foreign law (whether expert witnesses are admitted for example), and problems associated with the enforcement both of decisions rendered by courts and of arbitral awards.

The picture that emerged from the answers to the questionnaire did not vary greatly from one country to the other. There was a general acceptance of the freedom of the parties to choose the law they wanted to apply to the contract,(24) and in general it was felt that national courts were not reluctant to apply a foreign law. The means by which courts obtain information as to the content of foreign laws varied, a majority of countries however admitting expert evidence.

With the exception of Mexico, the franchisor's law was that indicated as the one chosen in practice as applicable to master franchise agreements, even if the U.K. answer indicated that it should be the sub-franchisor's law that applied. It was indicated that it was both possible and usual to have different laws apply to the master franchise agreement and to the sub-franchise agreements, even if a couple of answers expressed doubts as to the advisability of having such an arrangement (U.K., Ireland, Indonesia). Interestingly, a majority of the answers indicated that courts would be more likely to recognise the validity and enforceability of a choice of law and forum clause in an arbitration provision.

In general where no law had been chosen by the parties the answers indicated that courts would in most cases apply their national law, even if a couple of answers indicated that the law which would be applied depended on factors such as where the contract was to be performed or where it had been concluded (Argentina, Mexico, Italy, U.S.A.), or on

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(24) With the exception of certain areas of law for which the local law would always be applicable, such as real estate law, criminal law, competition law, intellectual and industrial property law and in general any law which could be considered to be a law of public policy.

which law was the law of closest approximation (Norway).[25] Courts in practically all the countries examined would however accept jurisdiction also when no law had been chosen by the parties, although certain conditions were indicated in some of the answers, such as the defendant being domiciled in the country (Norway), the suit being brought by a foreign franchisor against a local sub-franchisor (Korea) or one of the parties or the contract having connections with the country concerned (Ireland, Hong Kong).

As to the enforcement of foreign decisions, the answers from European Community countries referred to the 1968 Brussels Convention, those from EFTA countries referred to the Lugano Convention and others referred to reciprocal arrangements with other countries (Singapore, Hong Kong, New Zealand). The procedure by which foreign decisions are rendered enforceable in the countries varied greatly, some answers indicating that new procedures had to be initiated with the decision rendered by the foreign court constituting evidence only. The *1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards* was referred to in relation to the enforcement of arbitral awards in the answers which came from States Parties to the Convention. In general the indication was that arbitral awards rendered outside the jurisdiction of the sub-franchisor would be enforceable in the same way as decisions rendered by foreign courts.

In brief, parties would appear to be free to choose the law which they wish to apply to their contract, although in practice it will almost always be the law of the franchisor which will apply to master franchise agreements. Courts appear to accept these choices and do not show any reluctance in applying a foreign law chosen by the parties, even if problems might arise when it comes to ascertaining what this foreign law provides, a problem clearly not limited to franchising. Decisions rendered by foreign courts are as a rule enforceable in the countries considered, even if the procedures which have to be followed in order to render them so are often heavy and time consuming - again a problem which is not limited to franchising.

The fact that it is the franchisor's law which in most cases will apply to the agreements has often been held up as an abuse as it is considered that the franchisor will be advantaged. There are of course cases where the sub-franchisor is disadvantaged by such a choice, but one could wonder whether this is always so, particularly if the case is heard in the sub-franchisor's country, and the sub-franchisor does not have to go to great expense to hire lawyers and go through proceedings in a distant country: if the franchisor's

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[25] An interesting discussion of what the situation is where no law has been chosen by the parties is contained in M. HIESTAND, *Die international-privatrechtliche Beurteilung von Franchiseverträge ohne Rechtswahlklausel*, in *Recht der internationalen Wirtschaft* 1993, p. 173 et seq. The author discusses the question of which law should be considered to be the law of closest approximation in franchising contracts which by their very nature are composite contracts, particularly as regards trade mark licences. He arrives at the conclusion that it should be the franchisor's law which should be applicable, as otherwise there is a risk that franchisees of the same franchisor located in different countries could be ruled by different laws, which is a situation the author feels could be detrimental to the unity of the franchise system.

law has legislation regulating the franchise relationship it is likely that that law will be more stringent than the local law and will therefore involve more obligations which the franchisor has to comply with, to the advantage of the sub-franchisor (or franchisee). A closer examination of such instances would be necessary.

The question of different laws applying to the master franchise agreement and to the sub-franchise agreement and the problems which might arise in consequence is also one which would merit greater attention, as would the question of the applicable law in cases where no choice of law has been made by the parties.

III. TERMINATION OF MASTER FRANCHISE AGREEMENTS

When the question of problems arising in relation to the ending of a master franchise agreement is considered it is normally the specific situation of the termination of the agreement as a result of breach by one of the parties (normally the sub-franchisor) that one has in mind. In fact, the same problems arise also in relation to the expiry or non-renewal of the contract, and this was clearly evidenced in the replies to the questionnaire.

The first point considered in this respect was that of the legal effects of the expiry or non-renewal of the master franchise agreement. Practically all the answers indicated that in such a case the sub-franchisor would loose the rights granted by the agreement, i.e. it would have to cease using the trade marks of the frachisor, give back manuals received, stationary with the franchisor's logo, and other such items, take down any indication that the business is a franchise of the franchisor, pay any outstanding dues, etc. A few answers indicated that the effects would depend on the contract (the United Kingdom and the United States, the latter of which also indicated that this was further subject to the provisions of the law). As regards the differences with the termination situation, essentially the indication was that there was no great difference: the rights granted would always cease, and those obligations which had been designed to last beyond the end of the contract (non-competition clauses for example) would continue to be valid.

An important issue is that of the fate of the sub-franchise agreements upon the expiry, non-renewal or termination of master franchise agreements, in other words whether or not they will be terminated automatically.

The answers to this question varied considerably, even if there was a certain majority for the automatic termination option. Some indicated that as the rights granted in the sub-franchise agreements derived from the master franchise agreement the ending of the latter would inevitably result in the ending of the former as those rights no longer existed. Alternatively, even if the sub-franchise agreements were not automatically terminated, the sub-franchisees would not be able to continue doing business as they

would at that point be infringing the intellectual property rights of the franchisor (Sweden). Other answers indicated that sub-franchise agreements are never permitted to extend beyond the duration of the master franchise agreement (Ireland, U.S.A.).

The answers which indicated that the sub-franchise agreements would not be automatically terminated pointed to the fact that franchisors and sub-franchisees had no contractual relationships, that the sub-franchise agreement was an agreement between the sub-franchisor and the sub-franchisees and not between the franchisor and the sub-franchisees.

The Korean answer pointed out that the non-exclusive user right of the sub-franchisee to use the trade mark would be terminated if the exclusive user right of the sub-franchisor is deregistered upon the termination of the master franchise agreement, and the Swedish answer indicated that the sub-franchise agreement would be automatically terminated upon the termination of the master franchise agreement if the rights granted in the sub-franchise agreement stemmed from the master franchise agreement , but that separate rights could survive.

Some answers further indicated that it was possible for the master franchise agreement to contain provisions which would prevent the automatic termination of the sub-franchise agreements, i.e. provisions for the assignment of rights (Austria, Italy, New Zealand, Canada, Korea), provisions allowing the sub-franchisee to use the concept independently (Norway), third party beneficiary clauses (Canada), power of attorney clauses (Canada) and clauses in both the sub-franchise agreement and the master franchise agreement stating that the franchisor assumes all rights and obligations of the sub-franchisor (U.S.A.).

The possibility of avoiding this problem by means of the assignment of the rights of the sub-franchisor with respect to the sub-franchisee to the franchisor was specifically considered in the questionnaire. The majority of the answers indicated that the sub-franchisor could actually be required to assign its rights, title and interest in the sub-franchise agreements to the franchisor. The Austrian answer indicated that this was possible if the parties so agreed. Only in the case of Korea was government consent required for such an assignment. If the sub-franchise agreement so provided, the sub-franchisor would be required to accept the assignment.

All the answers indicated either that the sub-franchise agreement could contain a provision whereby the sub-franchisee recognises that the sub-franchisor has the right to make this assignment, or that it was a point the agreement should deal with. With the exception of Indonesia it was felt that it was appropriate for the master franchise agreement to provide for an automatic assignment of the sub-franchisor's rights to the franchisor upon termination due to default on the part of the sub-franchisor. Some

answers further indicated that the inclusion of such a provision in the sub-franchise agreement also would be appropriate (Switzerland, Portugal, Sweden, Korea).

The possibility of the sub-franchise agreement containing a provision facilitating the assignment of the sub-franchisor's rights to the franchisor was also considered in the form of a clear undertaking by the sub-franchisor to make such an assignment and the recognition by the sub-franchisee of such an assignment. In general such provisions were considered to be possible, with the exception of the Brazilian answer which considered that they were not.

The possibility of including in the master franchise agreement an irrevocable power of attorney from the sub-franchisor authorising the franchisor to sign an assignment agreement on its behalf was also considered, and a majority of the answers felt that this would be possible. The Mexican answer voiced doubts as to the irrevocability of such a power of attorney, doubts which were echoed in the Swedish answer which firmly stated that irrevocable powers of attorney were not possible.

Also the possibility of having an assignment in blank in each sub-franchise agreement, to be dated and used upon the termination of the master franchise agreement, was considered. A majority of the answers indicated that this would be possible, some indicated that such a provision might be legal (Norway, Singapore), that it might be legal if the assignment were an assignment for the future (Italy), that the date should however not be left blank (Indonesia). In Brazil on the other hand it was definitely illegal.

When considering other options available to the franchisor to achieve the assignment, a majority of the answers indicated either that there were no other options or that the only other option was court action.

Looking closer at the assignment of the sub-franchisor's rights, it was that such an assignment could be at the option of the franchisor and did not have to be obligatory, although the Hong Kong answer indicated that if the assignment was automatic it would be obligatory. As to whether the franchisor could choose only some assignments or had to accept all, most answers indicated that the franchisor could choose - again, Hong Kong pointed out that if the assignment were automatic, then such a choice would not be possible. A point which was not considered in this respect, but which should not be overlooked, is what happens to those franchises for which the franchisor does not exercise its option.

In general the answers indicated that it was not necessary for the franchisor to compensate the sub-franchisor for the assignment, although some indicated that this was a point which the parties could agree upon in the master franchise agreement (Brazil, Italy, Sweden, Norway, Singapore, Hong Kong). Similarly, it was generally agreed that no compensation would be due to the sub-franchisor specifically for the loss of business and

loss of clients upon the expiry of the contract if this was due to the assignment of its rights. A few answers indicated that this was a matter of contractual negotiations (Mexico, Ireland, Singapore, Korea). The one real exception to this tendency was the Austrian answer, which indicated that compensation would be due if the sub-franchisor had acquired customers or sub-franchisees and the economic advantage remained with the franchisor after the expiry of the agreement. Practically all the answers indicated that it was advisable and commercially acceptable for the master franchise agreement to contain an option for the franchisor to acquire all rights to the sub-franchise agreements as against compensation. The American answer indicated that this was a business decision.

The legal means by which the franchisor could enforce the sub-franchisor's obligation to assign its rights ranged from filing a claim in court for losses and damages (e.g. Brazil) or for specific performance (U.S.A., Hong Kong and New Zealand), and action for breach in general (Hong Kong) to inserting penalty clauses in the contract (Argentina, Indonesia), having the sub-franchisor sign an assignment clause without a date when entering into the contract (U.K.) or including a power of attorney in the master franchise agreement (U.K., New Zealand, Hong Kong).

The effects on the sub-franchise agreements of the termination of the master franchise agreement by the sub-franchisor for default on the part of the franchisor were also considered. Some answers indicated that the effects would be the same as when the sub-franchise agreement was terminated by the franchisor (Austria, Switzerland, Sweden, Norway, U.K. (unless the contract indicated otherwise), Singapore, Hong Kong), others that it depended on the terms of the master franchise agreement (U.S.A.). A few answers indicated that the sub-franchisor should be allowed to claim an indemnity (Brazil, Portugal), or to mitigate its losses (Ireland). The Korean reply indicated that the sub-franchisor could be liable for damages to sub-franchisees and could therefore claim damages from the franchisor to cover this also, and the Indonesian answer indicated that the sub-franchisees could sue both the franchisor and the sub-franchisor for the termination of the sub-franchise agreement.

As it is the sub-franchisor who is the point of reference for the sub-franchisees and who manages the network for the franchisor, when a master franchise agreement approaches its end the question will arise of whether of not the sub-franchisor should, or can, continue operating as sub-franchisor vis-à-vis sub-franchisees until the expiry of the last of the sub-franchise agreements. There was general agreement that there were no special requirements or impediments in this respect, although again some of the answers indicated that they would not expect sub-franchise agreements to last longer than the related master franchise agreement (Ireland, Indonesia). There was however general agreement that such an arrangement was not commercially desirable or even feasible even if it was possible, also in view of the complications which might arise should a second sub-franchisor be appointed, who would naturally develop a second network of sub-

franchisees. Complications in this respect would include possibly conflicting territorial exclusivity and problems for the franchisor in maintaining the quality standards of the performances of the first sub-franchisor and its sub-franchisees.

The ownership of the good will of the franchise was in general considered to belong to the franchisor. The Argentinian answer indicated that if the trade mark was unknown it would belong to the sub-franchisee, although the opposite could also be true. No restrictions were recorded as regards the possibility to stipulate in the agreement that the good will would belong to the franchisor and in most cases such a stipulation was seen as ensuring ownership of the good will. The Norwegian answer specified that the franchisor would have to pay economic compensation for the expansion of the good will.

IV. THE TRIPARTITE RELATIONSHIP BETWEEN FRANCHISOR, SUB-FRANCHISOR AND SUB-FRANCHISEES

Tripartite relationships such as that which exists between the franchisor, the sub-franchisor and the sub-franchisees give rise to problems which derive from the nature of the relationship itself. In the case of franchising the first of these problems concerns the use of trade marks.

The questionnaire enquired whether there were any restrictions or conditions imposed by legislation, court decisions or customs upon the ability of the owner of the trade mark (the franchisor) to grant the right to another (the sub-franchisor) to sub-licence the use of its trade mark.

A majority of the answers indicated that there were no such restrictions. The Swedish answer pointed out that although there were no restrictions, if the licensee did not have an express right to grant sub-licences it would not be allowed to transfer or sub-licence its rights. The U.K. and New Zealand answers indicated that sub-licencing was not advisable as it could put the trade mark in jeopardy. Indeed, the indication was that it is not possible to licence trade marks in Canada, the U.K., Ireland and Indonesia. The Canadian answer indicated that sub-franchisors and sub-franchisees could be registered as registered users, but would not be permitted to transfer the right to use the trade marks. As regards the trade mark there would in other words need to be a relationship between the franchisor and the sub-franchisees. In the U.S.A. there appeared to be no restrictions, but the master franchise agreement would have to grant the sub-franchisor the right to sub-licence. The Singapore correspondent stated that the owner of the trade mark must maintain a quality control over the use of the trade mark. If the sub-franchisor were allowed to sub-licence the trade mark the franchisor would no longer be deemed to be using the mark which would then be vulnerable to cancellation. The Korean correspondent pointed out that only the holder of an exclusive user right could sub-licence, i.e. grant a non-

exclusive user right, and only if the owner agreed. There were no restrictions in Hong Kong either, but the possibility was mentioned of such an arrangement being caught by the Pyramid Selling Prohibition Ordinance.

With reference to the infringement of licences, the question of whether sub-franchisors and sub-franchisees were entitled to institute proceedings for infringement or passing off against third parties was raised. Most of the answers indicated that sub-franchisors and sub-franchisees were entitled to institute such proceedings, in some cases where the owner failed to take action (U.K., Canada), in others after informing the owner (Sweden, Norway). Some countries would admit such proceedings only on the part of the sub-franchisor as the holder of exclusive rights (Yugoslavia, Portugal). There were differences within some countries depending on what the proceedings would concern. Thus, for example, in Italy the exclusive licensee would have a right to institute proceedings in relation to trade mark infringement, whereas every licensee would have such a right in relation to passing off; in Singapore only the owner of the trade mark would have a right to institute proceedings in infringement cases even if registered users could also do so if the owner refused to, and the owner of the good will would have such a right in relation to passing off. In Hong Kong the sub-franchisor or sub-franchisee would have to join the franchisor who is the owner of the good will, unless they can prove that they actually own the good will, and in the U.S.A. the sub-franchisee cannot bring a suit for infringement without joining the owner as a party in the proceedings.

The question of whether a franchisor could enforce its rights and force the sub-franchisor or a sub-franchisee to stop using its trade mark after the termination, expiry or assignment of the master franchise agreement was answered affirmatively by all respondents.

A related problem concerns the possibility of the franchisor preventing a sub-franchisee from using the trade mark as a result of the sub-franchisee misusing it, as the franchisor is not a party to the sub-franchise agreement. Some countries indicated that the owner had an independent legal interest in protecting the mark, and would thus be able to act (Norway, U.K., Italy). In the U.S.A. the owner was the only one who would be able to institute proceedings.

One point covered by the questionnaire was whether the franchisor has to be a party to the sub-franchise agreement in order to accept or enforce all the covenants in its favour contained in that agreement, but this was not considered to be necessary in most countries, even if some conceded that it might help. A third party beneficiary clause was considered to be sufficient in practically all the countries surveyed to give the franchisor the right to bring an action directly against the sub-franchisee.

Provisions in the agreements indicating that developments and improvements to the franchise made by the sub-franchisor or sub-franchisee belong to the franchisor were considered to be valid and enforceable in most of the countries, the exceptions being Brazil, where a patent or technology transfer belongs to the franchisee but a licence in the franchisor's favour may be provided for, and Korea, where an assignment of such improvements and developments to the franchisor seems to be acceptable. As a rule no compensation would be given for such a "grant back", although a few countries indicated that this was a matter of negotiation.

An important issue concerns the existence of liability on the part of the franchisor for acts of the sub-franchisor and sub-franchisees simply as a result of the relationship which exists between them and of the control exercised by the franchisor, or as a result of their use of the trade mark of the franchisor. The answers on this point varied greatly. Some indicated that there was nothing which would impose liability on the part of the franchisor (Austria, Switzerland, Italy, Mexico, Indonesia), but this negative answer was in other cases qualified by indications that the franchisor would be liable if the sub-franchisor or the sub-franchisees had been authorised by the franchisor to act as its agents (U.K., Ireland), and that the franchisor would be dragged into the proceedings if the use by the sub-franchisor or the sub-franchisees of the trade mark of the franchisor infringed the right of a third party in the territory concerned (U.K.).

Several answers referred to product liability as a sphere where liability on the part of the franchisor might arise. If the defective products are made under the supervision, control and direction of the franchisor this could give rise to action in tort in Argentina (in which case the third party who has been damaged would be able to proceed against either the franchisor, the sub-franchisor or the sub-franchisee). In Portugal also the franchisor would be liable as a manufacturer if in fact the franchisor operated as a manufacturer. The definition of "producer" in Norway includes whoever offers a product with its trade mark on it, and further if the products are part of a distribution chain compensation may be claimed from all links of the chain. The U.K. answer drew attention to the *draft EEC Council Directive on unfair terms in consumer contracts*[26] which provides for joint and several liability.

The importance of the degree of control exercised by the franchisor was stressed in several replies (Canada (which also stressed the importance of the advertising policy adopted), Norway, U.S.A., Singapore, Korea, Hong Kong). If a sub-franchisor or sub-franchisee runs the business under specific instructions of the franchisor this would expose the franchisor to the risks of other potential liabilities in Hong Kong, and also in the U.S.A..

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(26) For the Amended proposal for a Council Directive on unfair terms in consumer contracts, see OJ EEC No. C 73/7 of 24 March 1992.

The American situation is more complex, due also to the extensive and varied legislation which exists. Under franchise sales laws at federal level, but also in many states, the franchisor would have joint and several liability vis-à-vis any third party damaged by a sub-franchisor's violation of applicable franchise sales laws. The correspondent found no cases in which the franchisor had been found liable for the acts of sub-franchisees, even if they have been found liable vis-à-vis the customers of their franchisees, i.e. when there was no third level involved in the relationship. The liability of the franchisor in the U.S.A. may result either from its retention of control over the day-to-day operation of the sub-franchisor, or when the offering of a product to the public or the performance of a service under a uniform name or mark warrants that the product or service will be of a uniform nature and quality. In addition, liability could arise if the franchisee can demonstrate that a duty of care was owed to it by the franchisor, that this duty was breached and that the breach was the proximate cause of the damages sustained.

The Irish answer indicated that the liability of the franchisor depended on the relationship: if it was a master/servant relationship the franchisor would be vicariously liable, if it was one of principal and agent the franchisor would be liable, but if it was a partnership the test was whether the prospective partner was entitled to participate in the profits of the venture.

The issue of control is brought to a head in the consideration of whether or not the franchisor can be considered to be the employer of the sub-franchisor. The need to consider labour legislation in relation to a possible liability on the part of the franchisor was pointed out by the replies from Argentina, Norway, Ireland, and Korea. In Korea the definition of an employer is so broad that franchisors would seem to be covered by it in many cases: an employer is any person who supervises and controls another person undertaking the business of the former, regardless of the title of the contractual relationship between the parties.

The specific question of whether the control of the franchisor over the sub-franchisor under the master franchise agreement could lead courts to conclude that in fact it was an employment relationship received differing replies, some considering that it was not possible (Portugal, New Zealand), that it was improbable (Norway) or unlikely (U.K.), although it was admitted that it was possible (Sweden, Italy) or that at any rate vicarious liability was possible (Singapore). A few answers indicated that elements such as the payment of wages or a salary would be necessary (Mexico, Indonesia) or the payment of social security benefits (U.K., Ireland). The U.S. answer indicated that typically it would not be considered an employment relationship but that there was some basis for such a view under U.S. statute or administrative law.

The assumption of liability was also considered in the questionnaire in the form of stipulations in the sub-franchise agreement that the sub-franchisee will indemnify and hold harmless the sub-franchisor and the franchisor in connection with any claim by a third party that the sub-franchisee's conduct resulted in its being damaged, as was the question of the legality and enforceability of such stipulations. Most answers indicated that such stipulations were common and usual as well as valid and enforceable, with the exception of Singapore which indicated that this was not possible between the sub-franchisee and the franchisor as there was no privity of contract. The Indonesian reply was similar to that of Korea, although it considered that if all three parties so agreed, it might be possible.

A majority of the answers further indicated that it was common for the franchisor to hold the sub-franchisor and the sub-franchisees harmless and to indemnify them as regards third party claims alleging intellectual property infringement. The exceptions here were Switzerland, Italy, Portugal, Norway, and Indonesia.

The possibility that the franchisor's being a party to the sub-franchise agreement for the purposes of enforcing the sub-franchisor's rights would increase its liability was denied by most correspondents, with the exception of Mexico, Ireland, New Zealand and Singapore. The situation was unclear in the U.S.A. as such an arrangement might affect the vicarious liability of the franchisor vis-à-vis customers.

One option envisaged is that the franchisor retain the right directly to enforce any provision of the sub-franchise agreement against the sub-franchisee when the sub-franchisor has failed to do so despite a request to this effect by the franchisor. Most of the answers indicated that such an arrangement was both feasible and appropriate. The Swedish answer qualified its assent by saying that it was feasible and appropriate if the franchisor was a party to the sub-franchise agreement or if these rights were derived from the master franchise agreement. The U.K. correspondent indicated that it would be unwise for the franchisor to intervene as such an intervention could give rise to counterclaims. For the Canadian correspondent on the other hand it was appropriate and customary to do so, and as a means to this end reference was made to a third party beneficial interest clause in the master franchise agreement. The Korean answer specified that it would not be possible unless there was a provision to this effect in the sub-franchise agreement, and the Hong Kong response stated that the franchisor must be a party to the sub-franchise agreement and be expressly granted such rights.

The need to provide for such a retention of rights by the franchisor in the sub-franchise agreement was recognised by almost all of the correspondents in one way or another. Several indicated that the franchisor should be a party to the sub-franchise agreement, or at least that it would be advisable if it were (Brazil, Ireland, U.S.A., New Zealand, Singapore, Korea, Indonesia, Hong Kong). Others indicated that the franchisor should be granted such a right in the sub-franchise agreement without its having to be a

party (Austria, Switzerland, Italy, Portugal, U.S.A. (third party beneficiary clauses). The answers from Ireland and Singapore further indicated that the franchisor should intervene to accept these rights. The U.K. answer referred to a power of attorney as a means to retain such rights. Most replies however indicated that a third party beneficiary clause would suffice, with the exception of the U.K. as such clauses would normally not be permitted due to lack of consideration.

One point which would need to be considered further is whether the independence of both the sub-franchisor and the sub-franchisees might not be jeopardised if the franchisor were to become a party to the sub-franchise agreement, albeit only in relation to specific issues such as the enforcement of obligations deriving from the sub-franchise agreement. The question is whether a judge might consider that the nature of the franchise agreement has changed by the inclusion of such a provision, even if in fact it might turn out to be to the advantage of the sub-franchisees.

The possibility of a potential liability on the part of the franchisor as a result of this right to intervene, of there being counterclaims, set offs, compensations or defences, was also considered. The situation varied on this point from one country to another. In Mexico, Singapore and Korea this was possible, while in Switzerland in principle it would not occur although the wording of the provision would be crucial. In Portugal if the franchisor did not intervene expressly accepting the rights this would not be the case. The Irish answer indicated that set offs and counterclaims were possible by both the sub-franchisor and the sub-franchisees - either of these parties might seek to be indemnified by the franchisor for breach by the other party. This was echoed in the US answer, which indicated that a franchisor terminating a sub-franchise agreement could be subject to claims made by both the terminated sub-franchisee and the sub-franchisor. Counterclaims, set offs and other claims which would normally be available to terminated sub-franchisees would be available also in this case. The Swedish answer suggested that it might even be possible for the sub-franchisor to argue that the franchisor cannot terminate the agreement since it could have intervened.

As to whether or not it would be commercially acceptable for the franchisor to be in a position to intervene and to insist on strict legal enforcement of the sub-franchise agreement against a defaulting sub-franchisee as opposed to allowing the sub-franchisor to exhaust other techniques, most of the answers indicated that this would be commercially acceptable, with some reservations. The Irish answer indicated that it might be commercially acceptable, but that the sub-franchisor should be allowed to exhaust other techniques and the US answer indicated that the franchisor would probably wish the sub-franchisor to do so before intervening. The Mexican correspondent indicated that it would be ineffective and expensive and therefore not commercially acceptable, and the U.K. reply also indicated that it was not commercially acceptable.

CONCLUSION

The replies to the questionnaire examined in this document concerned the specific issues of the choice of law in master franchise agreements, the termination of master franchise agreements and certain problem areas associated with the tripartite nature of master franchising. Some of the issues raised would need to be examined further, as would questions which arose in the course of the examination and which had not been addressed (for example the fate of the sub-franchise agreements in respect of which the franchisor does not exercise its assignment option).

It was interesting to note that the solutions adopted did not always follow the distinctions between the families of legal systems, even when the countries concerned were geographically close as, for example, is the case with the United Kingdom and Ireland or Sweden and Norway.

Several of the issues raised did meet with a wide consensus, even if at times qualified, and could therefore form the basis on which to proceed in the examination of the feasibility and/or need for a uniform instrument. From the above examination, as well as from the research which has preceeded it, it can however be concluded that the area most suitable to treatment, at least in the first instance, is that of disclosure. The point to be decided is whether a uniform instrument dealing with disclosure should cover only domestic franchise relationships (in which case a model law might be the most suitable), or whether sub-franchisors should also be covered and if so whether it would be appropriate to extend the application of the model law covering franchisees also to sub-franchisors, or whether a separate instrument would be preferable and if so what kind of instrument.

ANNEX I

QUESTIONNAIRE

STUDY OF VARIOUS ISSUES ARISING IN CONNECTION WITH THE
NEGOTIATION AND DRAFTING OF
INTERNATIONAL MASTER FRANCHISE AGREEMENTS

INTRODUCTION

A franchisor's decision to export its franchise system internationally may be implemented through the use of different commercial vehicles. Generally speaking, there are three categories available: (i) direct franchising, whereby a franchisor grants franchises to franchisees in a foreign territory, either directly or through a subsidiary or brach office in such territory, without the intervention of a third party; consequently, there is a direct relationship between the franchisor and the foreign franchisee permitting such franchisee to operate a franchised outlet in such territory pursuant to a unit franchise agreement between the franchisor and such franchisee; (ii) joint ventures, whereby a franchisor will establish an entity in a foreign country with a partner, usually a national of such country, for the purpose of having such entity acquire from franchisor the right to establish and operate franchised outlets in such country and/or grant sub-franchises to others in such country to establish and operate franchised outlets; and (iii) master franchise agreements.

This study focuses exclusively on the master franchising vehicle as contemplated in international master franchise agreements. An international master franchise agreement is essentially an agreement entered into between a foreign franchisor and a sub-franchisor where the sub-franchisor is granted the right to itself establish franchise outlets and to grant sub-franchises to third party sub-franchisees to establish franchise outlets in an exclusive territory, typically in the country in which the sub-franchisor carries on business. Thus, the essence of an international master franchise agreement involves the granting of sub-franchising rights by a foreign franchisor to a domestic sub-franchisor.

There are many variations of the master franchising structure and, while it is beyond the scope of this study to examine each of the possible variations in the international master franchising context, it is crucial to remain continuously aware of the existence of these variations. In this context, one cannot speak of a "typical" master franchise relationship or agreement. While the master franchise relationship contains certain distinctive features, the variety of goals, the difference in negotiating power, the commercial expediency and other important factors produces a variety of outcomes from which it is difficult to extract any solid conclusions.

QUESTIONNAIRE

STUDY OF VARIOUS ISSUES ARISING IN CONNECTION WITH THE NEGOTIATION AND DRAFTING OF INTERNATIONAL MASTER FRANCHISE AGREEMENTS

I. TERM AND RENEWAL OF MASTER FRANCHISE AGREEMENTS

It is important to determine whether there are any restrictions imposed upon the freedom of the parties to the Master Franchise Agreement to choose the term of the agreement or to stipulate any conditions or requirements which must be satisfied by the sub-franchisor in order to exercise a right of renewal to extend the term of the Master Franchise Agreement for a further period of time.

It seems equally important to deal with the consequences of the expiration/non-renewal of the term of the Master Franchise Agreement. The sub-franchisor will have entered into numerous sub-franchise agreements with sub-franchisees within its territory, thus establishing a franchise network whose continued operation it is necessary to ensure.

A. Describe any legislation, jurisprudence or custom which may affect the ability of the parties to freely negotiate the term of the Master Franchise Agreement or the conditions of renewal of the term of the Master Franchise Agreement.

B.

1. **Is there any requirement that the term of a Master Franchise Agreement be for a finite period of time?**

2. **(a) What is the range of duration of the terms you have seen in negotiated Master Franchise Agreements?**

   (b) Does the Master Franchise Agreement remain in effect for a full stated term or for an initial term accompanied by a right of renewal for one or more additional term?

3. **(a) If the Master Franchise Agreement contains a right of renewal for an additional term, describe the conditions or requirements, if any, which the Master Franchise Agreement requires to be satisfied by the sub-franchisor in order to be entitled to exercise such right of renewal.**

(b) Describe the manner in which the issue of development requirements is dealt with at the time of renewal of the term. Must the franchisor and sub-franchisor agree on the development requirements at the time of renewal in order for the renewal to occur? Is the sub-franchisor granted a right of first refusal or an option in respect of further development during the renewal term?

4. (a) Describe the legal effects of the expiration/ non-renewal of the term of the Master Franchise Agreement?

(b) In the absence of any provision to the contrary effect, does the expiration of the term of the Master Franchise Agreement result in the automatic termination of the sub-franchise agreements?

(c) May the sub-franchisor be required to assign to the franchisor all of its rights, title and interest in and to the sub-franchise agreements entered into with sub-franchisees? Would governmental consents be required in your jurisdiction in order to effect such assignment? If so, how does the franchisor deal with the situation during the interim period (i.e. after termination but prior to issuance of the relevant governmental consents) ?

(d) Are the sub-franchisees bound to accept such assignment? May the sub-franchise agreement contain a provision whereby the sub-franchisee acknowledges that the sub-franchisor has the right to assign its rights, title and interest in the sub-franchise agreement?

(e) Must any compensation be paid by the franchisor to the sub-franchisor for such assignment of the sub-franchise agreements?

(f) What are the legal means available to the franchisor to enforce the sub-franchisor's obligation to assign the sub-franchise agreements to the franchisor?

(g) Must any compensation be paid to the sub-franchisor by reason of the sub-franchisor's loss of business and clients upon the expiration of the term of the Master Franchise Agreement? Would your

answer depend on whether the sub-franchisor's rights, title and interest in the sub-franchise agreements are assigned to the franchisor?

5. It is possible that in light of a quickly approaching expiration of the term of the Master Franchise Agreement, a sub-franchisor would be less inclined or lose its motivation to continue expanding the franchise network.

   (a) **Are there any requirements or impediments to allowing the sub-franchisor to continue acting as sub-franchisor in respect of the existing sub-franchisees in the territory,** notwithstanding the expi**ration of the term of the Master Franchise Agreement,** providing of course that (i) the sub-franchisor would no longer be entitled to grant any franchises, thus allowing the franchisor to enter the market or grant a new master franchise for the territory, and (ii) the Master Franchise Agreement would remain binding upon the sub-franchisor in respect of its on-going obligations towards the existing sub-franchisees and the franchisor (including the payment of royalties etc.) until the expiration of the term of the last sub-franchise agreement which was executed by sub-franchisor prior to the expiration of the term of the Master Franchise Agreement.

   (b) **Is this a commercially desirable or feasible alternative given that if the franchisor succeeds in recruiting another sub-franchisor, there would be two sub-franchisors in the same jurisdiction?**

C. **Include a provision dealing with term, renewal and consequences of expiration of the term contained in Master Franchise Agreements.**

II. DEVELOPMENT REQUIREMENTS

One of the fundamental characteristics of Master Franchise Agreements is the grant of exclusive rights to the sub-franchisor for the purpose of sub-franchising in its territory. In exchange for such exclusivity, franchisors will generally require that the sub-franchisor continually satisfy certain mutually agreed upon development requirements reflected in the Master Franchise Agreement. The sub-franchisor must, pursuant

to typical development requirements, ensure that a certain number of franchised outlets are in operation within the exclusive territory at certain predetermined intervals of time, usually yearly.

The importance attached to development requirements in Master Franchise Agreements demands that the consequences of the failure to satisfy such requirements be carefully examined.

A. Describe any legislation, jurisprudence or custom which may affect the scope, validity or enforceability of development requirements contained in Master Franchise Agreements.

B. 1. (a) Is a provision entitling the franchisor to terminate the Master Franchise Agreement upon failure of the sub-franchisor to satisfy the development requirements contained in the Master Franchise Agreement valid and enforceable?

(b) Is termination of the Master Franchise Agreement a commercially acceptable consequence of the failure to satisfy development requirements?

2. (a) If such termination right were exercised by the franchisor, would all sub-franchise agreements entered into by the sub-franchisor be automatically terminated?

(b) Alternatively, could the Master Franchise Agreement contain provisions providing for the sale and/or assignment by the sub-franchisor to the franchisor or to a designated successor sub-franchisor of all rights, title and interest of sub-franchisor in and to all existing sub-franchise agreements entered into with sub-franchisees?

(c) If your response is affirmative, would such sale and/or assignment be effected with or without consideration being payable by the franchisor to the sub-franchisor?

3. (a) Master Franchise Agreements sometimes stipulate that failure to satisfy development requirements will simply result in a loss of exclusive rights, thus entitling the franchisor to grant franchises in the territory or enter into a Master Fran-

chise Agreement with a new sub-franchisor in respect of the territory. Given that this would result in two entities recruiting future franchisees in the territory, Master Franchise Agreements often stipulate that upon such loss of exclusive rights, the sub-franchisor is prohibited from establishing additional franchised outlets or granting further sub-franchises. In such circumstances, the sub-franchisor would continue to act as such in respect of all existing sub-franchise agreements already entered into between sub-franchisor and sub-franchisees at the time of such loss of exclusive rights, and would continue operating franchised outlets established by the sub-franchisor and its affiliates prior to such loss of exclusive rights. **Is this a feasible alternative to termination rights in your jurisdiction and is it commercially acceptable?**

(b) To the extent that following a loss of exclusive rights, the franchisor decides to grant additional franchises or another master franchise in respect of the territory, material difficulties may arise given the presence of two franchisors in the territory (namely the "old" sub-franchisor in respect of existing sub-franchises at the time of loss of exclusive rights and the "new" sub-franchisor). **Is it advisable and commercially acceptable that the Master Franchise Agreement contain an option for the franchisor to acquire, for a consideration set forth in the Master Franchise Agreement, all the rights, title and interest of the sub-franchisor in and to all sub-franchise agreements in existence at the time of loss of exclusivity?**

4. (a) An alternative to termination and loss of exclusivity as consequences of the failure to satisfy development requirements might be the payment by the sub-franchisor of liquidated damages in the form of additional royalties based on the average sales volume of existing franchised outlets. **Would this alternative be valid and enforceable, and is it a commercially feasible alternative?**

   (b) **Is this type of liquidated damages an acceptable alternative to consistent growth of the franchised network in the territory?**

C. Include a provision dealing with development requirements and the consequences of failure of the sub-franchisor to satisfy development requirements contained in Master Franchise Agreements.

III. TRADE-MARK ISSUES

Material differences in national trade-mark legislation and practice give rise to difficult issues which must be addressed in any international agreements purporting to grant trade-mark licenses. It is important to understand the legal intricacies with which one should be concerned when preparing a Master Franchise Agreement for use between citizens of different nations. (For the purposes of this question, use of the term "trade-mark" is meant to encompass both the concepts of trade-marks and service marks).

A.

1. Describe any legislation, rule or regulation which may require disclosure and/or registration of any agreement purporting to grant a trade-mark license.
2. If registration is required, discuss whether a separate trade mark license agreement could be registered without registering the Master Franchise Agreement?
3. If registration is not required, is it nevertheless permitted? If permitted, describe the purpose and intent of such registration.
4. Are trade-marks considered part of technology or know-how and accordingly governed by laws relating to technology transfers or licensing of know-how?

B.

1. (a) Are there any restrictions or conditions imposed by legislation, jurisprudence or custom upon the ability of the owner of a trade-mark to grant the right to a third party (e.g. the sub-franchisor) to sub-license the use of such trade-mark to third parties (e.g. sub-franchisees)?

   (b) If your response is affirmative, are there any legal and commercially acceptable alternatives available to the franchisor that would achieve the same result as an agreement providing for the sub-licensing of the trade-marks?

2. Would a covenant of the sub-franchisor not to contest the validity or registration of trade-marks owned by the franchisor in the jurisdiction of the sub-franchisor be valid and enforceable?

3. To whom does the goodwill resulting from the use of the trade-marks by the sub-franchisees belong? Are there any restrictions against stipulating in the sub-franchise agreement that such goodwill belongs to the franchisor as owner of the trade-mark? Can such a stipulation ensure ownership of such goodwill by the franchisor?

4. (a) Under current trade-mark legislation, are the sub-franchisor and sub-franchisees, as users of the licensed trade-marks owned by the franchisor, entitled to institute proceedings for trade-mark infringement or "passing-off" against third parties? At whose expense?

   (b) If your response is affirmative, what is the common practice, if any, in this respect? For example, are contractual restrictions on anyone other than the franchisor instituting such proceedings valid and enforceable?

   (c) Describe the procedure to be followed in circumstances where a "passing-off" or an infringement action is to be taken.

5. Are there any restrictions or legal risks involved in licensing or sub-licensing trade-marks which have not been registered with appropriate authorities or trade-marks in respect of which an application for registration is pending?

6. Can a franchisor readily and efficiently enforce its rights to cause the sub-franchisor to cease using the licensed trade-marks upon termination or expiration of the term of the Master Franchise Agreement or after an assignment of the Master Franchise Agreement by the sub-franchisor? Whether or not the franchisor is party to the sub-franchise agreement, can it readily and efficiently enforce its rights to cause any sub-franchisee to cease using the licensed trade-marks upon termination or expiration of the term of the sub-franchise agree-

ment or after an assignment of a sub-franchise agreement by a sub-franchisee?

7. (a) A franchisor, as owner of the licensed trade-marks, may wish to enforce its rights against the sub-franchisees for misuse of the licensed trade-marks in circumstances where the sub-franchisor is not acting diligently in this respect. How can this be accomplished given that the unit franchise agreement is entered into between the sub-franchisor and sub-franchisees while the franchisor is not a party thereto?

   (b) Must the franchisor also become a party to the sub-franchise agreement or may the franchisor simply intervene for the sole purpose of accepting and enforcing all covenants made in its favour in the sub-franchise agreement or is there some other method of achieving this objective?

   (c) Is a provision in the sub-franchise agreement to the effect that the franchisor is entitled to exercise certain rights contained in its favour in the sub-franchise agreement (i.e. third party beneficiary or "stipulation pour autrui") enough to give the franchisor right to bring action directly against the sub-franchisee?

C. Include trade-mark provisions dealing with licensed trade-marks contained in Master Franchise Agreements as well as in the sub-franchise agreements entered into pursuant to the Master Franchise Agreement.

IV. RESTRICTIVE COVENANTS (NON-COMPETITION) AND CONFIDENTIALITY PROVISIONS

Franchisors tend to attach tremendous importance to provisions in Master Franchise Agreements whose purpose is to restrict the sub-franchisor's ability to compete against the business of the franchisor, whether directly or indirectly. Substantial time, effort and money has been devoted by the franchisor to the development of a franchise system which is complete in all respects. Many elements comprising the franchise system are trade secrets of and proprietary to the franchisor. Even when most of such elements (when examined individually and not as a part of a greater whole) are not confidential or proprietary to the franchisor, the combination of the various facets of the

franchise system were painstakingly assembled by the franchisor into a business format which enjoys reasonable success.

Disclosure of all aspects of the franchise system is then made to the sub-franchisor. It becomes crucial at this point for the franchisor to ensure that the sub-franchisor cannot make use of or divulge the imparted information for its benefit outside the franchise system or for the benefit of others or compete with the business of the franchisor after being apprised of such information.

A. Is there any legislation, jurisprudence or custom imposing conditions upon the validity of restrictive covenants (non-competition) and confidentiality obligations ?

B. 1. (a) **Are there any restrictions to the validity and enforceability of provisions in the Master Franchise Agreement which prohibit the sub-franchisor from competing directly or indirectly with the business of the franchisor during the term of the Master Franchise Agreement?**

(b) **If your response is affirmative, describe the factors (e.g. duration of restriction, geographical scope) which may be considered in order to determine whether such restrictive covenants are valid.**

2. (a) **Are there any restrictions to the validity and enforceability of provisions in the Master Franchise Agreement which prohibit the sub-franchisor from competing directly or indirectly with the business of the franchisor after (i) the termination or expiration of the term of the Master Franchise Agreement or (ii) an assignment of the Master Franchise Agreement by the sub-franchisor?**

(b) **If your response is affirmative, describe the factors (e.g. duration of limitation, geographical scope) which may be considered in order to determine whether such restrictive covenants are valid.**

3. Confidentiality provisions are also normally found in Master Franchise Agreements requiring the sub-franchisor to maintain the confidentiality of information disclosed to it by the franchisor or obtained

by the sub-franchisor in the course of its relationship with the franchisor.

(a) **What are the attributes, if any, which such information must possess in order to benefit from such contractual confidentiality requirements?**

(b) **Are there any legal restrictions prohibiting the licensing of such confidential information as opposed to the sale of such confidential information?**

(c) **Are there any confidentiality obligations imposed upon the sub-franchisor by legislation, jurisprudence or custom?**

(d) **Are there any exceptions which result from legislation, jurisprudence or custom as to the information which may be subject to contractual confidentiality obligations?**

(e) **Are there any restrictions on the duration of such confidentiality obligation? (i.e. must it coincide with the term of the Master Franchise Agreement or may the parties stipulate that such obligations remain in effect beyond the termination or expiration of the term of the Master Franchise Agreement?)**

4. Master Franchise Agreements and sub-franchise agreements often contain "grant-back" provisions, providing that all developments or improvements made by the sub-franchisor or the sub-franchisee, respectively, in respect of the know-how forming part of the franchise system and all intellectual property rights relating thereto belong exclusively to the franchisor, but the sub-franchisor or the sub-franchisee, as the case may be, is deemed to have been granted by the franchisor a royalty-fee license to use such developments and improvements.

   (a) **Are such provisions valid and enforceable?**

   (b) **Must there be any consideration paid for this "grant-back" of ownership?**

   (c) **If such "grant-back" provisions are not valid or enforceable, would it be possible to stipulate**

that the sub-franchisor or the sub-franchisee, while remaining owner of developments to the franchisor's know-how, is required to grant to the franchisor a license to use and to grant sub-licenses for the use of such developments or improvements? Can such license in favour of the franchisor be required to be exclusive?

(d) **Must there be any consideration paid for such a license being granted to the franchisor?**

C. Include a typical provision dealing with the topics of restrictive covenants and confidentiality contained in Master Franchise Agreements.

V. **LIABILITY**

The rapid development of the law concerning liability issues in some jurisdictions has resulted in the inclusion of detailed provisions in Master Franchise Agreements dealing with these matters. A particular concern for franchisors is the increasing likelihood of becoming liable for the acts of its sub-franchisors which cause damages to third parties; it is also a concern for both the franchisor and the sub-franchisor in the context of the sub-franchisor's relationship with its sub-franchisees.

A. Describe any legislation, jurisprudence or custom which may impose liability upon the franchisor for the acts of the sub-franchisor as well as for the acts of sub-franchisees of the sub-franchisor simply by reason of the franchise relationship existing between the franchisor and sub-franchisor (e.g. degree of control by the franchisor over the sub-franchisor's activities or the degree of control by the sub-franchisor over the sub-franchisee's activities being deemed excessive etc.) or by reason of the use or method of franchisor's trade-marks by the sub-franchisor and its sub-franchisees (e.g. without identifying the sub-franchisor or sub-franchisee as the operator of the business carried on under the franchisor's trade-marks).

B. 1. (a) **Is it usual for Master Franchise Agreements to stipulate that the sub-franchisor must indemnify and hold harmless the franchisor from any loss, damage, liability and expenses which may be incurred by the franchisor in connection with any claim by a third**

party that the sub-franchisor's conduct has resulted in damages to such third party?

(b) May such "indemnification" provisions stipulate that attorney's fees incurred by the franchisor in connection with such claims are to be reimbursed by the sub-franchisor to the franchisor?

2. (a) May the Master Franchise Agreement contain a requirement that the sub-franchisor maintain insurance in effect to cover the risk incurred by the franchisor in connection with such "vicarious liability"?

   (b) If your response is affirmative, may the Master Franchise Agreement require that the franchisor be named co-insured on such insurance policy?

3. Is it legal, enforceable and commercially acceptable for the sub-franchise agreements to stipulate that the sub-franchisee must indemnify and hold harmless not only the sub-franchisor but also the franchisor from any loss, damage, liability and expenses which may be incurred by the franchisor and the sub-franchisor in connection with any claim by a third party that the sub-franchisee's conduct has resulted in damages to such third party?

4. The sub-franchisor obviously has its own concerns as to potential liability resulting from its use of intellectual property forming part of the franchise system. Is it common for a franchisor in a Master Franchise Agreement and in a sub-franchise agreement to indemnify and hold harmless the sub-franchisor and its sub-franchisees against any damage, liability, loss or expense incurred by the sub-franchisor and its sub-franchisees in connection with any claim made by a third party that the use by the sub-franchisor and its sub-franchisees of various intellectual property forming part of the franchise system infringes upon the proprietary rights of such third party?

5. Discuss whether the franchisor being a party to the sub-franchise agreement between the sub-franchisor and a sub-franchisee (solely for the purpose of enforcing the sub-franchisor's rights against the sub-franchisee, without any independent obligations

under the sub-franchise agreement) will increase its liability as compared to a situation where the franchisor is not a party to such agreement.

6. **Discuss whether the degree of control which the franchisor may have in the Master Franchise Agreement over the sub-franchisor could allow a court in your jurisdiction to conclude that the relationship between the franchisor and the sub-franchisor is one of employer and employee?**

C. Include provisions dealing with liability and insurance which should be contained in Master Franchise Agreements as well as in sub-franchise agreements.

VI. FORM OF SUB-FRANCHISE AGREEMENT

The form of sub-franchise agreement to be used by the sub-franchisor to grant franchises to sub-franchisees is of crucial importance for many different reasons. The sub-franchisor must ensure that this agreement is fair by standards prevailing in its jurisdiction, in order that it not become difficult to convince potential sub-franchisees to acquire the franchise on the terms and conditions reflected in the sub-franchise agreement. On the other hand, the franchisor sees in the sub-franchise agreement its only effective means to protect the integrity, characteristics and use of all elements of its proprietary franchise system, including its trade-marks.

Consequently, friction will arise in connection with negotiations relating to the Master Franchise Agreement, where the franchisor will often attempt to require that the sub- franchise agreement which must be entered into by the sub-franchisor with its sub-franchisees remain the standard form sub-franchise agreement used by the franchisor in its home jurisdiction; the sub-franchisor will attempt to have this standard form modified to the fullest extent that it deems appropriate for use in its jurisdiction.

A. **Are there any issues arising in sub-franchise agreements which legislation or jurisprudence requires be dealt with in a particular manner, regardless of the desires of the parties to the sub-franchise agreement?**

B. 1. (a) Many franchisors would agree that their standard form sub-franchise agreement should reflect the

laws, customs and business realities of the jurisdiction in which it is to be used. Is there still widespread reluctance to such changes and adaptations as franchisors export their franchise systems to your jurisdiction or are the instances of such reluctance isolated?

(b) If such reluctance still prevails, briefly describe which suggested adaptations are the most controversial.

2. (a) The language of the standard form sub-franchise agreement of the franchisor may be different than the language of the jurisdiction to which its franchise system is being exported. Consequently, the unit franchise agreement is often translated into the language of the relevant jurisdiction. Are there any legal requirements in respect of the language of the sub-franchise agreement?

   (b) Is it usual for two versions, or a bilingual version, of the sub-franchise agreement to be used in your jurisdiction?

   (c) If your response is affirmative and the Master Franchise Agreement is silent on this issue, which will prevail in the event of a conflict between the two versions?

   (d) Are there any conditions affecting the legality of a translation of a Master Franchise Agreement?

   (e) Should the ownership of the copyright in the translation be specifically dealt with in the Master Franchise Agreement?

3. Could an English or French version of the sub-franchise agreement be accepted for use in your jurisdiction without translation into another language? Would this be commercially acceptable?

C. Include a provision contained in Master Franchise Agreements dealing with: (a) the form and content of the sub-franchise agreement to be used by the sub-franchisor; (b) changes and adaptations which may be suggested by the sub-franchisor to the franchisor's standard form sub-franchise agreement; (c) changes and adaptations

which may be required by the franchisor to the standard form sub-franchise agreement subsequent to the execution of the Master Franchise Agreement.

VII. TERMINATION OF MASTER FRANCHISE AGREEMENT

Some of the more difficult issues relating to international Master Franchise Agreements arise in the context of provisions dealing with termination of the Master franchise Agreements as a result of a breach or default of the sub-franchisor. A significant investment of time, effort and money will have been made by both parties to ensure the viability and success of a franchise system. There will be a tendency for the franchisor to retain important termination rights in order to be in a position to salvage the franchise network in the jurisdiction and protect its investment. The sub-franchisor will also insist on being in a position to protect its investment. It is important to reconcile these contrary pressures and arrive at a compromise which affords the franchisor the reasonable protection it needs while offering some reassurances to the sub-franchisor that termination rights will only become applicable in reasonable circumstances.

A. (a) Describe any legislation, jurisprudence or custom which imposes limitations on termination rights which may be contractually agreed upon in the Master Franchise Agreement.

(b) Describe any legislation, jurisprudence or custom which requires that compensation be paid to the sub-franchisor upon termination of the Master Franchise Agreement.

B. 1. (a) The franchisor often feels that its only true lever of control over the manner in which the franchise system is managed by the sub-franchisor consists of a right to terminate the Master Franchise Agreement in circumstances where the sub-franchisor fails to fulfil its obligations in its capacity as a franchisor under sub-franchise agreements entered into between the sub-franchisor and sub-franchisees. **Is this the manner in which this control is exercised in Master Franchise Agreements applicable in your jurisdiction?**

(b) Are there alternative solutions which may be considered by the franchisor in order to ensure that the franchise network is being properly managed?

2. (a) Rights of termination resulting from the bankruptcy or insolvency of the sub-franchisor must be customized to the bankruptcy laws of each jurisdiction. **Describe pitfalls, if any, to be avoided when preparing such termination provisions.**

   (b) Under current bankruptcy and insolvency legislation, is there any danger that the trustee or liquidator of an insolvent or bankrupt sub-franchisor is entitled to continue operating or to sell its rights, title and interest in the Master Franchise Agreement? If so, can the inclusion of certain provisions in the Master Franchise Agreement reduce or eliminate this danger?

3. **(a) Does the sub-franchisor have any contractual right to terminate in most Master Franchise Agreements? Does the sub-franchisee have any contractual right to terminate in most sub-franchise agreements?**

   (b) If your response to either question in paragraph 3.(a) is affirmative, describe the circumstances in which such termination rights would be applicable.

4. **Are sub-franchisors (in Master Franchise Agreements) and sub-franchisees (in sub-franchise agreements) typically given a reasonable period to remedy defaults which are by their nature capable of being remedied?**

C. Include termination provisions contained in Master Franchise Agreements.

VIII. EFFECTS OF TERMINATION OF MASTER FRANCHISE AGREEMENTS

The difficulties arising in dealing with the effects of termination of a Master Franchise Agreement lie largely in determining the manner in which the sub-franchise agreements will be dealt with following termination of the Master Franchise Agreement.

It would appear that in some jurisdictions, the absence of any provisions dealing with this matter would result in all the sub-franchise agreements being de facto terminated upon the termination of the Master Franchise Agreement, by reason of the

fact the entity having been granted rights under the sub-franchise agreement has lost all right and capacity to act in the manner contemplated by the sub-franchise agreement. Consequently, it is crucial for the franchisor to avoid the decimation of its franchise network upon the termination of the Master Franchise Agreement.

A. (a) Under the laws of your jurisdiction, assuming the Master Franchise Agreement is silent on this issue, would all sub-franchise agreements be de facto terminated upon termination of the Master Franchise Agreement?

(b) If your response is affirmative, would the sub-franchisee have a cause of action against the franchisor if the possibility of such premature termination of the sub-franchise agreement was not disclosed to the sub-franchisee prior to its execution of the sub-franchise agreement?

B. 1. **To the extent that termination of the Master Franchise Agreement would in fact result in termination of the sub-franchise agreements, are there any contractual provisions that can be incorporated into the Master Franchise Agreement that would prevent such effect upon termination?**

2. **(a) Is it appropriate for the Master Franchise Agreement to provide that upon the termination of the Master Franchise Agreement due to the default of the sub-franchisor, the sub-franchisor is required to transfer and assign all its rights, title and interest in and to the sub-franchise agreements to the franchisor. Is there any mechanism by which such assignment may be made to occur automatically, without any action by the sub-franchisor?**

(b) Given that the default of the sub-franchisor has caused such termination, most franchisors would wish such assignment of sub-franchise agreements to be effected without consideration. **Is there any legislation, jurisprudence or custom which prohibits such assignment from being effected without consideration?**

(c) Would a nominal consideration suffice?

3. (a) Considering that it is likely that following the termination of the Master Franchise Agreement as a result of the sub-franchisor's default, the sub-franchisor may not willingly comply with its post-termination obligations including assigning its rights in all sub-franchise agreements to the franchisor. Is it possible to include in the Master Franchise Agreement an irrevocable power of attorney from the sub-franchisor authorizing the franchisor to sign an assignment agreement on its behalf in respect of such sub-franchise agreements?

   (b) As an alternative to the use of a power of attorney, is it legal and desirable to require sub-franchisor to sign, contemporaneously with the signature of each sub-franchise agreement, an assignment agreement in respect of each such sub-franchise agreement in favour of the franchisor, leaving the effective date blank, with the undertaking from the franchisor that such assignment agreement would be dated and used by the franchisor solely upon termination of the Master Franchise Agreement?

   (c) Are there any other legal means available to the franchisor to achieve the foregoing assignment?

   (d) Would such assignments of sub-franchise agreements by the sub-franchisor to the franchisor be obligatory upon termination of the Master Franchise Agreement or may it be stipulated to be at the option of the franchisor?

   (e) Must the franchisor accept an assignment of all sub-franchise agreements or may the franchisor choose to have only certain sub-franchise agreements assigned to it?

4. Describe any provision which should be contained in the sub-franchise agreement in order to facilitate the assignment of the sub-franchisor's rights, title and interest therein to the franchisor.

5. Describe the effect that a termination of the Master Franchise Agreement by the sub-franchisor in

the event of a default by the franchisor would have upon the sub-franchise agreements?

C. **Include a provision dealing with the effects of termination of a Master Franchise Agreement.**

IX. CHOICE OF LAW AND FORUM

As is the case with all international commercial agreements, the choice of law and forum provision is usually the subject of lengthy discussions and negotiations between the parties to the Master Franchise Agreement.

There is often a strong tendency for the franchisor to insist that the law of its home jurisdiction govern the Master Franchise Agreement and that the forum for all disputes also be chosen from within its home jurisdiction. The sub-franchisor will strongly oppose such a proposition, claiming that the laws of its jurisdiction should govern, given the fact that most obligations under the Master Franchise Agreement must be performed in its jurisdiction thereby rendering its jurisdiction appropriate both for the choice of governing law and forum for disputes.

A. Describe any legislation, jurisprudence, custom or inter-governmental treaty which generally restricts the freedom of the parties to choose the governing law or forum for litigation, arbitration or other dispute settlement mechanism. Describe any legislation, jurisprudence, custom or inter-governmental treaty which restricts such freedom solely in respect of particular issues (e.g. intellectual property, competition law etc.).

B. 1. **(a) Is there any particular tendency in negotiating Master Franchise Agreements which dictates the choice of law or forum (e.g. law and forum are from the franchisor's home jurisdiction)?**

(b) If your response is affirmative, discuss whether tribunals in your jurisdictions express any reluctance in applying the governing laws chosen by the parties.

(c) If the governing laws are those of another jurisdiction, describe the manner in which courts in

your jurisdiction determine the terms of such laws are (e.g. expert testimony etc.).

2. What procedures, if any, must be followed to render executory and enforceable a decision of a foreign court rendered pursuant to the choice of law and forum provision contained in a Master Franchise Agreement? Are there any enforcement treaties in effect between your nation and other nations?

3. (a) If the parties have not made provision for applicable law or forum in the Master Franchise Agreement, will your tribunals accept jurisdiction?

   (b) Which laws will govern the Master Franchise Agreement in such circumstances?

4. Are there any specific areas of the law in your jurisdiction in respect of which the laws of your jurisdiction will always apply, notwithstanding that the parties may have chosen different governing laws (e.g. trade-mark or other intellectual property laws, competition laws etc.)?

5. (a) Are courts more likely to recognize the validity and enforceability of a choice of law and forum in an arbitration provision contained in the Master Franchise Agreement?

   (b) Would an arbitration decision rendered outside the jurisdiction of the sub-franchisor pursuant to arbitration provision in the Master Franchise Agreement be executory and enforceable in the jurisdiction of the sub-franchisor and under what conditions ?

6. Is it possible to have a sub-franchise agreement entered into pursuant to a Master Franchise Agreement governed by laws that are different from those which govern such Master Franchise Agreement?

C. Include a provision dealing with choice of law and venue in Master Franchise Agreements.

X. PROTECTION OF FRANCHISE SYSTEM THROUGH FRANCHISOR INTERVENTION

International Master Franchise Agreements are used in circumstances which require the franchisor to entrust the development and management of its franchise system to the sub-franchisor in the relevant territory. Many franchisors fear such loss of control and attempt to retain the right to intervene in various circumstances. Consequently, it is important to determine whether such intervention is legal, feasible and appropriate and determine the means with which it may be accomplished.

A. Describe any legislation, jurisprudence or custom imposing restrictions against such franchisor intervention.

B. 1. Franchisors will usually insist that the best form of protection of their franchise system lies in their contractual right to terminate the Master Franchise Agreement upon the failure of the sub-franchisor to fulfill its obligations as franchisor towards its sub-franchisees under the sub-franchise agreements it has entered into or upon its failure to properly supervise the use of the franchise system throughout the relevant territory. **Is it feasible and appropriate for the franchisor to retain the right to directly enforce any provision of the sub-franchise agreement against sub-franchisees in circumstances where the sub-franchisor has failed to do so upon request of the franchisor?**

2. **(a) How can the franchisor retain such rights against the sub-franchisees? (must the franchisor be a party to the unit franchise agreement? must the franchisor intervene into the sub-franchise agreement to accept the rights granted to it by the sub-franchisor and the sub-franchisee?)**

(b) Would a third party beneficiary or "stipulation pour autrui" clause (whereby the franchisor is declared to be entitled to exercise certain rights directly against the sub-franchisee) contained in the sub-franchise agreement suffice?

3. **Describe any potential liability which may be incurred by the franchisor by reason of its having the right to so intervene. Might there be counter claims, set offs, compensations or defenses with which the franchisor may have to cope?**

4. There are several techniques, other than strict enforcement of the sub-franchise agreement, available to the sub-franchisor in dealing with defaults of its sub-franchisees, some of which fall short of legal action. Is it commercially acceptable for the franchisor to be in a position to intervene and insist on strict legal enforcement of the sub- franchise agreement against the defaulting sub-franchisee, as opposed to allowing the sub-franchisor to exhaust such other techniques?

C. Include a provision of a sub-franchise agreement which would allow the franchisor to enforce rights directly against the sub-franchisee.

XI. CURRENCY ISSUES AND FLOW OF MONEY

These issues arise in the context of most international and the commercial agreements but have a particularly important impact on the relationship between the franchisor and the sub-franchisor; this relationship may continue for a particularly lengthy period of time and its survival depends on the continued ability of the sub-franchisor to make payments of royalty to the franchisor in consideration of the use of the franchisor's system and trade-marks and the services rendered by the franchisor to the sub-franchisor.

A. 1. Is there any legislation currently in effect which prohibits the payment of amounts owing under the Master Franchise Agreement by the sub-franchisor to a franchisor situated outside your jurisdiction?

2. Is there any legislation currently in effect which requires that the sub-franchisor withold a portion of payments made to a non-resident franchisor and remits same to tax authorities in your jurisdiction? If so, is the portion to be witheld different depending on whether the payment is an amount of royalties, interest or for services rendered? Are there any tax treaties entered into between the government of your jurisdiction and those of other jurisdictions which reduces the portion to be witheld?

B. 1. Restrictions on the flow of currency which are imposed after the execution of the Master Franchise Agreement represent a substantial risk for the foreign franchisor. **Are there any provisions which may be included in the Master Franchise Agreement in order to reduce such risk? More particularly, are there any effective recourses which may be provided in favour of the franchisor which do not involve termination of the Master Franchise Agreement?**

2. **(a) Is it legal, enforceable and commercially acceptable for the Master Franchise Agreement to contain a requirement that all payments thereunder be made in a currency other than the currency of the jurisdiction of the sub-franchisor?**

(b) Some Master Franchise Agreements provide that in the event of failure by the sub-franchisor to make any payment when due under the Master Franchise Agreement, the conversion of currency shall be made for such payment at the most favorable exchange rate between the date such payment was due and the date such payment is actually made by the sub-franchisor. Would such a provision be valid and enforceable in your jurisdiction?

3. The franchisor may suffer a substantial loss of profits if it is not entitled to an income tax credit in its own jurisdiction which is equivalent to the amount required under the laws of the sub-franchisor's jurisdiction to be witheld from payments owing to the franchisor.

(a) Is it legal, enforceable and commercially acceptable to include a requirement in the Master Franchise Agreement that payments to the franchisor which are subject to witholding taxes in the sub-franchisor's jurisdiction but do not entitle the franchisor to an equivalent income tax rebate in the franchisor's jurisdiction, be increased to an amount which, after witholding of the appropriate amount under the laws of the sub-franchisor's jurisdiction, is equal to the amount which would otherwise be required to be paid to the franchisor under the Master Franchise Agreement if there was no such witholding requirement ?

XII. ADDITIONAL RESTRICTIONS

Are there any matters typically dealt with in Master Franchise Agreement but not otherwise dealt with in this questionnaire which cannot be freely negotiated by the parties (e.g. ability of the parties to negotiate royalty fees, etc.) by reason of some legislation, jurisprudence or custom applicable in your jurisdiction?

ANNEX II

LIST OF COUNTRIES COMPRISED IN THE LEGAL GUIDE

Countries in italic are those from which answers have been received.

Argentina
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Austria
Belgium
Brazil
Canada
Chili
Czechoslovakia
Denmark
Finland
France
Germany
Greece
Hong Kong
Hungary
Indonesia
Ireland
Israel
Italy
Japan
Korea
Malaysia
Mexico
Norway
The Netherlands
New Zealand
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Russia
Singapore
South Africa
Spain
Sweden
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United Kingdom
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