

UNDERSTAND THE PITFALLS



Andrae Marrocco, a Canadian franchise lawyer evaluates the five most commonly overlooked provisions in international franchise agreements

Franchising has become one of the most popular business expansion options, one that is particularly effective when developing into international markets. Franchises that grow with a well-structured system, a thoroughly thought out plan, and exceptional legal documents have the best chance of success. Systems that look to expand without these key elements can end in disaster. There are several matters that a modern franchise agreement should address when growing internationally however they are frequently overlooked. Don't be caught out by these five pitfalls.

PLAN FOR CHANGE

In an era of rapid change, even the best strategy, planning and due diligence by a franchisor cannot perfectly predict the market reaction to a brand or its products and services. A robust international strategy includes risk assessment and early-stage monitoring mechanisms, together with a thorough 'Plan B'. A prosperous international strategy that is not supported by a clear and comprehensively drafted franchise agreement, which leaves room for tweaking or modifying, will inevitably lead the brand or system to flounder. An international franchise agreement must be designed in a way that makes it most resilient in the face of the unexpected. This involves considering a range of potential outcomes and alternative approaches that the franchisor might take in expanding to the foreign territory such as changes to the system service offering to meet unexpected market

reactions. Most importantly, such tailored drafting goes far beyond use of a pro forma system modification clause found in many franchise agreements.

NOTE THE NUANCES

Some foreign territories have entirely different legal systems. Ironically, those territories can be less dangerous than territories that are closer in proximity and similar in franchise regulation. This is because franchisors fail to take notice of the subtle differences in closer and more similar territories which often results in significant challenges down the road. This problem often rears its head when US franchisors expand into Canada. With the ever-expanding body of case law in Canada, an international franchise agreement covering the region must be reviewed carefully to ensure that it reflects the laws current in Canada at the time. Generally speaking, the customisation process need not be protracted, and in many cases is not arduous, but it needs to be done competently, and as close to signing as possible. By way of a more specific example, in Canada it has been held that selecting Ontario, which has franchise legislation, as the governing law for franchises operated outside of Ontario (where there might not be franchise legislation) invokes the Ontario franchise legislation and makes disclosure mandatory, although it would not have otherwise been required. Another example is that general releases required under a Canadian franchise agreement, at time of sale or renewal, may

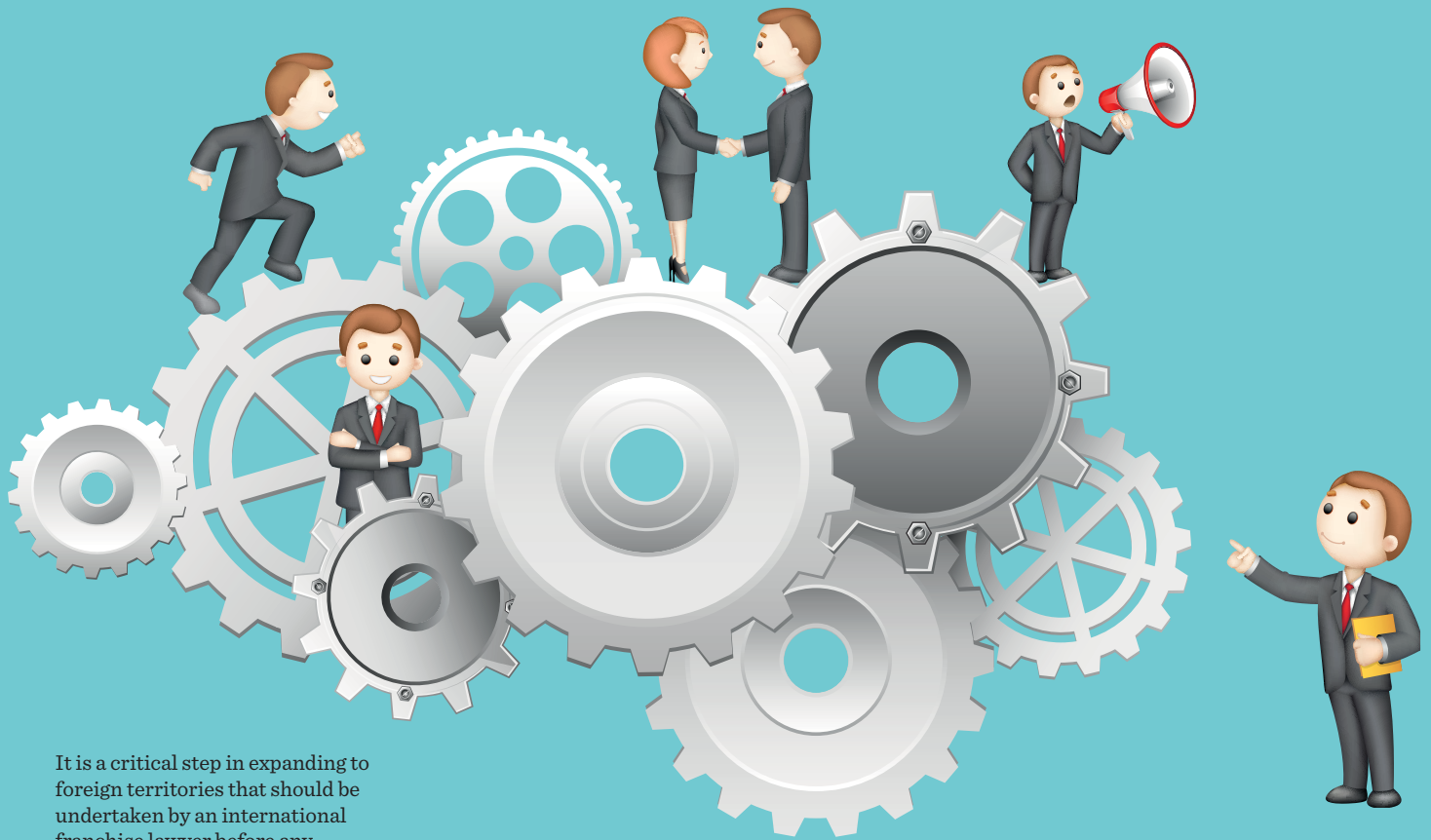
not be enforceable if the rights of franchisees under the relevant franchise statute are not carved out.

WHO, WHAT, WHERE?

Online presence and social media have become a major aspect of documenting the rights and responsibilities of franchising parties. They become even more important when drafting international franchise agreements. There are many questions you need to consider when devising an international franchise agreement such as: How will the use of the internet and hosting of websites be divided between the franchisor and the franchisee in the foreign territory? Can the franchisee market and sell online, or will the franchisor host a specific webpage for the new territory and refer leads to the franchisee? You also need to recognise the importance and responsibility of social media. Will the franchisor prepare the social media policy for the foreign territory, or will this be controlled by the franchisee? In determining who will host and manage the foreign territory's specific website, the franchisor has to balance the need to maintain control of the brand with the fact that the franchisee is better placed to understand its market. Whatever your strategy, it needs to be well-planned and understood before the agreement is signed.

SCRUTINISE THE STRUCTURE

Tax planning and corporate structuring in international franchise arrangements is often undervalued, overlooked and poorly implemented.



It is a critical step in expanding to foreign territories that should be undertaken by an international franchise lawyer before any agreement is prepared. It is equally important that the parties understand the planning and structuring under which the franchise arrangement will operate, and to ensure that the agreements reflect that planning and structure. Try to answer all of the following questions before drafting an agreement. Do one or more individuals comprise the franchisee? Is it a corporate franchisee? Are the individual shareholders providing personal guarantees? Has the franchisor incorporated one or more entities for the international expansion? Will one such entity have the rights to grant the trademark license to the franchisee? What is the intended process for repatriation of profits? Are there withholding taxes and how will they be dealt with?

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A ROBUST INTERNATIONAL STRATEGY INCLUDES RISK ASSESSMENT AND EARLY-STAGE MONITORING MECHANISMS, TOGETHER WITH A THOROUGH 'PLAN B'”

where there is a breakdown of the relationship and a breach of the agreement by the franchisee. Once the franchisor has determined what rights it should have to revise, terminate or grant to the franchisee, those mechanisms should be tested against the regulatory backdrop of the foreign jurisdiction. In an age of increased regulation and litigation, franchisors should not rely simply on standard default and termination provisions. Attention must be paid to all franchise laws, relationship laws, breach and termination principles and non-competition laws. Recently in Canada, a non-competition covenant was not upheld by the court – not because of any issues

with the time frame or geographic scope of the provisions – but because it demonstrated that the franchisor had no intention of replacing the franchisee in that territory and therefore it was held that the franchisor did not have a sufficient proprietary interest to protect in the relevant region that required the court to enforce the non-competition covenant.

These are but a few of the often overlooked considerations that should be specifically addressed in drafting and negotiating international franchise agreements – that assist franchisors in establishing robust systems which are more likely to succeed.

TERMINATION AND ENFORCEABILITY

Understandably, franchisors typically hope for the best, however they need to plan for the worst. The reality is that considering the ‘end game’ at the beginning of the relationship is absolutely critical. This requires a tailored approach in carefully analysing the range of likely potential outcomes and the alternative approaches in circumstances

★ ABOUT THE AUTHOR

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