Drafting and Negotiating an International Franchise Agreement

International Franchise Toolkit: A dynamic, invaluable resource for franchisors expanding overseas.

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AS PART OF ITS commitment to its members and the worldwide franchise community, the International Franchise Association has embarked upon another novel and exciting project. By creating the International Franchise Toolkit, a Web-based resource center housed on its website www.franchise.org, the IFA has created a dynamic and invaluable source of information for any franchisor wishing to expand beyond its home market. This article is a brief synopsis of one of the key elements of the Toolkit.

THE STARTING POINT

If asked, "When does the work begin to draft and negotiate an international franchise agreement?", most people charged with the task of steering the course of a franchise system's international expansion would respond: "When we have an interested candidate who is ready, willing and able to sign." In reality, the work should begin when such an expansion is in the planning stages.

A franchisor intending to be a serious player on the international franchise stage needs the input of its franchise attorney from the very beginning. Proper planning for such a development should include not only what legal structures are available, i.e., master franchising, area development, area representation, unit franchises or joint venture, but what the pros and cons are of each vehicle. Such input should extend to the appropriateness of one structure over others, by specific country or region. The choice of structures will influence many of the business decisions, such as the franchisor's capital requirements (initially and ongoing), the speed of expansion, what human resources are needed, what jurisdictions and when, and much, much more.

THE GOAL

The primary goals in drafting an international franchise agreement are for the franchisor to end up with a legally enforceable agreement, which protects the brand and provides for a desired economic return for the franchisor. Everything else about such a process flows from those goals. Solid knowledge about the target market and good initial planning will make those goals significantly more attainable.

WHICH MARKETS AND WHEN?

The choice of expansion markets, the order and the timing, will have a profound impact on the resources needed by the franchisor. Equally, these factors will impact on the choice of legal structures and the content of the franchise agreements needed to support the expansion. Master franchising, with its downloading of most of the responsibilities to the master franchisee for the expansion of the system in the target market, might be the optimum approach for more distant and less familiar places. Unit franchising, area development and area representative arrangements might be more effective for the franchisor when the market is close and more familiar.

Master franchise agreements are some of the most tailored agreements in the international franchise marketplace. Consequently, they are the most expensive agreements to produce each time and take the longest time to negotiate. Unit franchising, development and representative agreements tend to be more consistent across jurisdictions and are less likely to be negotiated.

The cultural norms and legal systems of the target market will have an impact on the drafting and negotiation of an international franchise agreement. For example, a franchisor may not be comfortable with the laws and judicial system of a target market and therefore may wish to have any future disputes adjudicated in its home jurisdiction and by the laws of that home jurisdiction. Pushback by a prospective foreign franchisee may give rise to an extensive negotiation, possibly leading to the choice of a third jurisdiction's arbitration system and laws.

LETTERS OF INTENT

The value of a non-binding or partially binding letter of intent as a precursor to the drafting and negotiation of an international franchise agreement cannot be overstated. Unlike a domestic franchise program, where the deal is pretty much carved in stone before the franchisee is presented with

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agreements to sign, international franchise agreements, as mentioned above, tend to be more specific to the particular parties and localities. Further, franchising in less familiar foreign jurisdictions to prospects less familiar with franchising, brings a much greater likelihood for misunderstandings from the time a deal is struck in principle to the time when an agreement is presented for signing.

Thoughtfully prepared letters of intent can go a long way in avoiding extensive redrafting of documents. By using such letters, the franchisor can also avoid the very costly waste of money and time that comes with an otherwise worthy candidate bolting at the last minute because it was surprised by the content of the ultimate agreement.

SIGNIFICANT DEAL POINTS

Most of the business terms of any international franchise deal will be obvious to the business people, such as front-end franchise fees, length of the term, territory, revenue sharing, performance criteria, source of products and supplies and operational considerations at the unit level. However, some not so obvious matters, which often do not show up until an agreement is drafted, could sink an otherwise propitious deal, such as:

- The currency for payments to the franchisor,
- Crucial events of default,
- The requirement of the franchisee to post security,
- Personal guarantees,
- What happens to existing operations on termination,
- The extent of the initial term, renewal terms and conditions to renewal,
- Conditions to assignment by the franchisee and fees charged by the franchisor for consent, and
- Control of parallel marketing channels.

Identifying these potential problem areas early in the process will go a long way to avoiding unpleasant surprises. However, even if such items are inserted in a letter of intent, prospective franchisees may not have the expertise to fully understand their impact and it is their lawyer who sounds an alarm, only after the letter is signed. Often, the lawyer chosen by the prospective franchisee will have a significant impact on the time it takes to negotiate an international franchise agreement. It is best to encourage the prospective franchisee to involve its legal advisor early in the process and to choose a lawyer who is familiar with franchise matters.

LAWS OF THE TARGET JURISDICTION

It is wise for the franchisor's lawyer to select a capable local counsel at the earliest stage possible in the drafting and negotiation of an international franchise agreement. Knowing what the impact of specific local laws will be on the agreement will avoid costly delays in finalizing the agreement and provide the franchisor with a more realistic picture of what powers it can reserve and rely upon in the event of a default, renewal, assignment or expiration.

CONCLUSION

Successfully drafting and negotiating an international franchise agreement is dependent upon finding the ideal mix of expertise, experience, local knowledge, planning and patience. ■

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