Focus INTERNATIONAL TRADE

Talk to a franchise lawyer before going global

Ned Levitt

An international franchise expansion can be a profitable strategy for Canadian franchise companies, or a complete disaster. From the beginning, a franchisor intending to be a serious player on the international stage needs the input of their franchise lawyer to avoid costly disasters. For example, one Canadian fast-food franchisor simply relied upon a consultant to prepare their U.S. franchise disclosure document. The document was not prepared properly, which led to many successful franchisee lawsuits and the resulting financial collapse of the franchise. In another case, a Canadian clothing franchisor realized too late, after franchisees had commenced doing business, that its trademarks could not be used in England.

Proper planning should include consideration of the following key components to successful international franchise expansion.

The first point of investigation before entering a foreign market should be the availability of system trademarks for use, and the ability to protect and grow the brand there.

Intellectual property, particularly trademarks but increasingly copyright in software, is one of the most valuable assets of a franchise system.

The choice of 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 closer and more familiar.

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Master franchise agreements are some of the most tailored agreements in the international franchise marketplace. Consequently, they are the most expensive to produce 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.

Target jurisdiction laws are also important. Over 30 countries have specific franchise legislation which runs from simple notice filings to full disclosure documents that must pass the scrutiny of regulators for registration. Some countries also require significant regulation of the relationship between the franchisor and the franchisee. In addition, many statutes throughout the world, while not directly regulating franchising, can have a significant impact on the conduct of businesses in the specific country. 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 the impact of specific local laws on the agreement will avoid costly delays in finalizing it, 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.

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 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 when an agreement is presented for signing.

Thoughtfully prepared letters of intent set out the guts of the deal and any specific points which could be contentious later. Such letters can avoid the waste of money and time that comes with an otherwise worthy candidate bolting at the last minute because they were surprised by the content of the ultimate agreement.

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 might not show up until an agreement is drafted:

- The currency for payments to the franchisor;
- Crucial events of default, such as termination after three notices of default, even when cured;
- 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;
- Control of parallel marketing channels, such as the sale of the same food products in grocery stores.

Identifying these potential problem areas early in the process will go a long way toward avoiding unpleasant surprises. However, even if inserted in a letter of intent, a prospective franchisee 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.

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Remedy: Non-market economy treatment seen as humiliating

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with the U.S. and EU, those protections will be provided to Canadian investors by virtue of the most-favoured nation (MFN) obligation in FIPA. Further, many are unaware that FIPA does not restrict Canada's ability to review and decide whether to approve or reject acquisitions of Canadian businesses under the *Investment Canada Act*, or China's freedom to do so under its laws.

Chinese exports are the focus of Canadian trade remedy actions, enabled by the frequent treatment of China as a non-market economy under Canada's principal trade remedy legislation, the *Special Import Measures Act*. Canada has also filed a World Trade Organization (WTO) complaint against a Chinese trade remedy measure against Canadian goods, a significant step and signal to China. That matter is before the WTO.

Perhaps most significantly, Canada took the pre-emptive step of amending its trade remedy legislation to continue its legal authority to treat certain sectors of the Chinese economy as being non-market oriented beyond the generally agreed expiration date in late 2016 set out in Article 15 of China's WTO accession protocol. Non-market economy treatment is seen as humiliating to China because of its pride in its many market-oriented economic and legal reforms over the past 30 years. It also typically has the consequence of inflating anti-dumping duties on Chinese originating goods that are imported into Canada. The Canadian amendment has received negative attention from the Chinese government and is being watched closely by other governments that are WTO signatories, which may wish to emulate Canada's amendment in their domestic trade remedies legislation.

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