

**International
Comparative
Legal Guides**



Practical cross-border insights into franchise law

**Franchise
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1 Relevant Legislation and Rules Governing Franchise Transactions

1.1 What is the legal definition of a franchise?

The U.S. Federal Trade Commission (“FTC”) promulgated 16 C.F.R. Part 436 (the “FTC Franchise Rule”) to regulate the offer and sale of franchises in the U.S. Under the FTC Franchise Rule, a commercial business arrangement or relationship will be deemed a “franchise” if the terms of the contract (whether oral or written) satisfy the following three elements:

- (i) the franchisee will obtain the right to operate a business that is identified or associated with the franchisor’s trademark, or to offer, sell, or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark;
- (ii) the franchisor will exert or has authority to exert a significant degree of control over the franchisee’s method of operation, or provides significant assistance in the franchisee’s method of operation; and
- (iii) as a condition of obtaining or commencing operation of the franchise, the franchisee will either make a required payment or commit to make a required payment to the franchisor or its affiliate. The FTC’s Compliance Guide provides that the required payment must be a “minimum of at least \$500 during the first six months of operations”.

While many states have franchise-related laws, there is no uniform legal definition of a “franchise”. Various states’ laws mirror the FTC Franchise Rule’s definition of a franchise. For example, the laws of California, Illinois, Indiana, Iowa, Maryland, Michigan, North Dakota, Oregon, Rhode Island, Virginia, Washington, and Wisconsin provide that a “franchise” exists if, under the terms of the contract:

- (i) a franchisee is granted the right to offer, sell, or distribute goods or services under a marketing plan or system prescribed or suggested in substantial part by a franchisor;
- (ii) the operation of the franchisee’s business pursuant to such plan or system is substantially associated with the franchisor’s trademark, service mark, trade name, logotype, advertising, or other commercial symbol designating the franchisor or its affiliate; and

- (iii) the person granted the right to engage in such business is required to pay to the franchisor or an affiliate of the franchisor, directly or indirectly, a franchise fee of \$500 or more.

The laws of Hawaii, Minnesota, Mississippi, Nebraska and South Dakota vary from the FTC Franchise Rule model by identifying a “community of interest” rather than a “marketing plan” as an element of a “franchise”. A “community of interest” means a continuing financial interest between the franchisor and a franchisee in the operation of the franchised business.

Connecticut, Missouri, New York and New Jersey provide a “two-pronged” definition of a “franchise”. For example, New Jersey law provides that a franchise exists where:

- (i) there is a written agreement in which one person grants another a licence to use a trade name, trademark, service mark, or related characteristic; and
- (ii) there is a community of interest in the marketing of the goods and services being offered.

The New York’s Franchise Sales Act’s (“NYFSA”) “two-pronged” approach provides for a more expansive definition of a franchise. A franchise exists under the NYFSA where: (i) the franchisee pays a franchise fee (the “First Prong”); and (ii) the franchisee *either*: (a) operates under a marketing plan; or (b) is granted the use of a trademark (the “Second Prong”).

1.2 What laws regulate the offer and sale of franchises?

The FTC Franchise Rule imposes a pre-sale disclosure requirement that applies to all states, obligating franchisors to furnish prospective franchisees with information and data regarding the material terms of the franchise relationship prior to consummating the sale of a franchise. Franchisors disclose this material information in a prescribed format commonly referred to as a Franchise Disclosure Document (“FDD”). In addition, 15 states have registration and/or disclosure requirements that must be met before a franchise can be offered and sold in that state. Eleven of these states require that, before franchisors may commence franchise sales activities in their states: (i) there must be a state agency review and approval of the FDD; and (ii) the franchisor must register its franchise programme with the state. Twenty-five states have Business Opportunity Laws, which extend the disclosure protections afforded to franchisees

as well as to consumers who purchase business opportunities, including franchises. Under Business Opportunity Laws, franchise sellers are typically obligated to prepare and disclose certain information to prospective franchisees prior to the consummation of a sale of a franchise. Typically, the information required to be disclosed by franchise sellers under Business Opportunity Laws is less extensive than what is required to be disclosed under the FTC Franchise Rule or applicable state franchise laws. Franchisors may be provided with an “exemption” or “exclusion” from Business Opportunity Laws, provided that they are in compliance with the FTC Franchise Rule. Obtaining the exemption or exclusion, in some cases, may require the filing of a notice to qualify for the exemption (e.g., Florida, Kentucky, Nebraska, Texas and Utah).

1.3 If a franchisor is proposing to appoint only one franchisee/licensee in your jurisdiction, will this person be treated as a “franchisee” for purposes of any franchise disclosure or registration laws?

Yes. Business format franchising is the primary method by which franchisors elect to expand their brand in different domestic consumer markets. However, “direct franchising” is not the typical method of franchising for U.S.-based franchisors looking to establish their presence internationally. Franchisors seeking global expansion of their brand are more likely to partner with a single franchisee/licensee (“Master Franchisee/Sub-Franchisor”) to develop, market and operate units under the franchisor’s brand within a specified geographic region outside of the U.S. Notwithstanding this approach, this form of expansion is more commonly referred to as “master franchising”. A Master Franchisee/Sub-Franchisor is treated as a franchisee for the purposes of franchise disclosure and registration laws. The Master Franchisee/Sub-Franchisor is afforded the same franchise disclosure and registration protections as if it was a “typical” franchisee for various reasons, including the fact that it makes a substantial investment in the franchisor’s system. However, because the Master Franchisee/Sub-Franchisor typically “steps into the shoes” of the Franchisor and assumes many of the duties of the franchisor by selling and offering franchises in its territory, the Master Franchisee/Sub-Franchisor will be required to provide appropriate disclosure to its “sub-franchisees”.

1.4 Are there any registration requirements relating to the franchise system?

The FTC Franchise Rule does not require franchisors to register their FDDs with a federal administrative or governmental agency. It only imposes a pre-sale disclosure requirement on franchisors. However, as noted in the response to question 1.2 above, there are 15 states that require a franchisor to either: (i) register their FDD; or (ii) file a notice of intent with the appropriate regulatory authority prior to commencing the offer or sale of franchise or multi-unit development rights within the state. Notwithstanding this lack of requirement under the FTC Franchise Rule, most franchisors will require their franchisees or Master Franchisees/Sub-Franchisors to comply with all local laws.

1.5 Are there mandatory pre-sale disclosure obligations?

Any violation of the FTC Franchise Rule’s disclosure requirement is a violation of the U.S. Federal Trade Commission Act,

and grants the FTC the right to sue franchisors in federal court and to seek any or all of the following remedies: (i) civil penalties of up to \$11,000 per violation; (ii) injunctive relief with respect to violations of the FTC Franchise Rule, including barring franchise sales in the U.S.; and (iii) restitution, rescission, or damages on behalf of the affected franchisees. While the FTC can bring an action against franchisors who violate the FTC Franchise Rule, no such private right of action is granted to aggrieved franchisees. Although franchisees do not have a private right of action under federal law, state franchise disclosure laws permit an aggrieved franchisee to bring an action against the franchisor for violations of state registration and disclosure laws. These claims typically include actions for rescission of the franchise agreement and/or actions for actual damages (including reasonable attorneys’ fees and expenses). There has been a great deal of criticism over the lack of a private right of action under the FTC Franchise Rule and, as of February 1, 2022, a bill was introduced in the United States Congress (H.R. 6551) to introduce a private right of action under the FTC Franchise Rule.

With respect to pre-sale disclosure requirements, franchisors may look to the Franchise Registration and Disclosure Guidelines (the “Guidelines”) promulgated by the North American Securities Administrators Association, Inc. (“NASAA”) as a resource (along with other NASAA publications). NASAA is a voluntary association with a membership consisting of 67 state and territorial securities administrators in the 50 U.S. states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada and Mexico. NASAA facilitates multi-state enforcement actions, information sharing and education (including the publication of new materials). The Guidelines provide an item-by-item breakdown of the information required to be disclosed in FDDs.

On May 19, 2019, NASAA adopted three new cover pages that were to be incorporated into FDDs as of January 1, 2020. These new pages include: “How to Use this Franchise Disclosure Document”, “What You Need to Know About Franchising” and “Special Risks to Consider about This Franchise”. The NASAA website provides instructions for use of the new cover pages (<https://www.nasaa.org/industry-resources/franchise-resources/>). On June 10, 2020, NASAA’s Franchise Project Group circulated guidelines to state franchise administrators for the review of Financial Representations after most businesses had been significantly impacted by the COVID-19 pandemic (see the response to question 1.7 below), the effects of which continue to be felt in 2022.

In addition to the above, franchisors may also consult the FTC’s Franchise Rule Compliance Guide for an interpretation of the various disclosure requirements of the FTC Franchise Rule (<https://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf>).

1.6 Do pre-sale disclosure obligations apply to sales to sub-franchisees? Who is required to make the necessary disclosures?

The FTC Franchise Rule imposes a pre-sale disclosure requirement on franchisors selling franchises using the business format method of franchising, but no such pre-sale disclosure requirement applies to sub-franchisees. While the FTC Franchise Rule does not directly address master franchising, NASAA has adopted a Multi-Unit Commentary (as of September 16, 2014) that provides franchisors with practical guidance concerning their disclosure obligations with respect to certain multi-unit franchising arrangements, including master franchising. Under the NASAA guidelines, Master Franchisors are required to prepare a separate FDD (from the FDD the franchisor uses

for unit franchisees) for offering and selling sub-franchise rights to prospective franchisees, because the relationships and agreements for sub-franchise rights are very different than those offered in a unit franchisee's FDD; combining them in the same FDD would lead to confusion. This pre-sale disclosure requirement is not only imposed on Master Franchisees offering and selling sub-franchise rights to prospective franchisees and multi-unit developers, but also upon Master Franchisees/Sub-Franchisors who "step-into" the franchisor's shoes and engage in franchise sales activities and provide training and support to sub-franchisees. Therefore, under the NASAA guidelines, Master Franchisees/Sub-Franchisors are responsible for preparing and providing their own FDD in connection with their offer and sale of sub-franchises and, where applicable, complying with state registration requirements.

1.7 Is the format of disclosures prescribed by law or other regulation, and how often must disclosures be updated? Is there an obligation to make continuing disclosure to existing franchisees?

Under the FTC Franchise Rule, franchisors are obligated to furnish prospective franchisees and multi-unit developers with certain material information through the prescribed format of an FDD. The purpose of the FDD is to provide prospective franchisees and multi-unit developers with the information they need to make an informed decision about investing in the franchisor's franchise system. The FDDs, which are the most essential component of the pre-sale due diligence process, are uniform in structure and comprise 23 categories ("Items") (which are laid out in the FTC Franchise Rule) of detailed information and accompanying exhibits regarding, among other things: (i) the history of the franchisor (and any parent or affiliate), including any history of bankruptcy or litigation; (ii) the business experience of the franchisor's principals; (iii) the recurring or occasional fees associated with operating the franchised business; (iv) an estimate of the franchisee's initial investment in order to commence operations; (v) the products (and sources for those products) that the franchisor requires the franchisee to use and/or purchase in connection with the operation of the franchised business; (vi) any direct or indirect financing (along with the terms of such financing) being offered by the franchisor; (vii) a list of all of the franchisor's word marks, service marks, trademarks, slogans, designs, and patents that will be used in connection with the operation of the franchised business; (viii) the territory in which the franchisee will operate, along with any rights retained by the franchisor to operate or cause a third party to operate in such territory; (ix) the exit strategies available to the franchisee and franchisor; (x) a description of how disputes are resolved; and (xi) the franchisor's financial performance, etc.

One of the Items that prospective franchisees and multi-unit developers usually deem to be amongst the most vital in analysing the franchise opportunity are financial performance representations concerning existing franchised and company-owned units. Such financial performance representations reflect past or projected revenues or sales, gross income, and net income or profits. Franchisors are not required by federal or state law to provide prospective franchisees with this information. However, if they choose to do so, they may provide the information in FDD Item 19; provided that there is a reasonable basis for the information and such information is properly and accurately disclosed. Improper or misleading financial performance representations can (and have, in many instances) give rise to a governmental or private cause of action under federal, state and/or common law (although there is no private right of action under the FTC

Franchise Rule). The NASAA provides commentary (adopted May 2017) on certain aspects of the financial performance representations that may be disclosed under Item 19.

The FTC Franchise Rule requires new annual information (including updated audited financial information) to be made within 120 days of the end of each fiscal year. In addition, at the end of each fiscal quarter, a franchisor must prepare and include in "Item 22" an attachment reflecting any "material" changes to its FDD (e.g., bankruptcy filings or pending litigation filed against the franchisor).

In addition to the federal requirement to update an FDD, certain states require the franchisor to update the FDD and submit amendment filings (e.g., in California, Maryland, Michigan, New York, North Dakota and Rhode Island, a franchisor must "promptly" update its FDD and file an amendment with the state agency whenever there is a material change to the disclosed information).

Notably, in the aftermath of the COVID-19 pandemic, various states have begun to utilise online filing systems (e.g., New York State recently adopted NASAA's Electronic Filing System).

1.8 What are the consequences of not complying with mandatory pre-sale disclosure obligations?

The consequences of non-compliance with either federal or state disclosure laws, or even common law, can be very significant. This can present a minefield for the unwary franchisor, as a myriad of federal and state regulatory frameworks can intersect, each with their own varied repercussions for non-compliance, depending upon the jurisdiction.

Under federal law, violations of the FTC Franchise Rule are deemed "unfair or deceptive acts or practices" in violation of Section 5 of the FTC Act. The FTC can initiate enforcement actions against franchisors, and the FTC may exercise broad investigatory powers in doing so, including the ability to investigate, take testimony, examine witnesses, issue civil investigatory demands ("CIDs"), and issue subpoenas, enforceable in federal court (see, e.g., 15 U.S.C 46, 49, 57, and 16 CFR Sec. 2.5). If a violation is found, the FTC may seek to have an administrative enforcement proceeding in front of an administrative law judge ("ALJ"), and any decision of the ALJ is enforceable in federal court. Remedies may include preliminary and permanent injunctive relief, including potentially barring a franchisor from conducting business or engaging in certain conduct (15 U.S.C Sec. 56(b)), civil penalties, restitution of aggrieved parties, and other equitable relief. Such enforcement actions by the FTC are relatively uncommon in the franchise context, although, in recent years, there has been some indication of renewed interest by regulators in enhancing enforcement.

Many individual states also have their own franchise disclosure regulatory enforcement scheme, typically enforced through a state's Attorney General's ("AG") office, depending upon the state-specific franchise consumer protection law. While remedies differ by state, these state statutes can allow state regulators to impose fines, obtain preliminary and permanent injunctive relief (again, including potentially barring a franchisor from conducting business within the state), and relief for aggrieved parties, such as damages, restitution, or rescission. Some state violations are even punishable as crimes.

Not only can disclosure violations lead to enforcement actions by regulators, but they may also subject a franchisor (or inadvertent franchisor) to liability directly from franchisees. The federal FTC Act does not provide for a private right of action (although there has been recent discussion that Congress may re-address that issue). However, as discussed herein, many states

have “Little FTC Acts”, which do provide franchisees with private rights of action for violations of the federal FTC Franchise Rule under a particular state’s “Little FTC Act”. Many of these state-specific consumer protection acts grant significantly augmented damages, including in some cases, multiples of damages, punitive damages, and attorney fee-shifting. In addition to state Little FTC Acts, there are currently 15 states (see question 1.2 above), which have their own state-specific franchise registration or disclosure obligations (in addition to the federal FTC Franchise Rule), and 25 states have Business Opportunity Laws, which must be complied with. Each of these state statutes has its own applicable remedies, and many not only provide regulators with enforcement powers, but also permit damaged parties to maintain private rights of action. Many of these state franchise disclosure laws provide for private rights of action for disclosure violations, so that franchisees may directly sue a franchisor for disclosure violations (see, e.g., N.Y. GBL 691; CA Corp Code. 31300), and in some cases, also impose individual liability on officers, directors, control persons, or principals of franchisors engaging in prohibited activity (see, e.g., NY GBL 681(13), 691(3); CA 31302).

Further, even where a technical right of action may not be available to an aggrieved party based upon disclosure requirements alone, the presence of disclosure violations can lead to a greater risk of liability for common law claims, including fraud and misrepresentation, or even for violations of the implied covenant of good faith and fair dealing. In large part, an FDD (with its many protective disclosures and disclaimers) is a protective document for a franchisor, and franchisors are well advised to take care to show that a prospective franchisee properly received a compliant FDD.

Finally, in the continuing climate of the COVID-19 pandemic, the conflict in Ukraine, and continuing disruptions in supply chains and fuel availability, franchisors should be particularly mindful of the need to update their disclosures, as both federal and state law often require franchisors to provide interim disclosures or amendments if circumstances have materially changed. “Material changes” to a franchised system’s operations may be triggered by governmental mandates (e.g., mandating closures, or re-opening, of “in person” interaction with customers), by material changes to financial conditions, or significant fuel costs or supply chain issues, even in the middle of a disclosure cycle. These external factors can also cause significant changes in revenues, or closures of units. Abnormal financial declines, or conversely, abnormal growth in a “rebound” following a steep decline, should be potentially “disclosed” as being caused by unusual external factors (such as COVID-19). There have also been global and regional disruptions in global supply chains, including those brought on by COVID-19, the war in Ukraine, and the availability of energy, fuel, required goods and services (or lack thereof). Conflict-related sanctions may significantly impact overseas operations, particularly for international franchise systems operating in, or relying upon, targeted regions. All of these may call for amendments (e.g., FTC Act; Item 8: Restrictions on Sources of Products and Services), and franchisors are well-advised to be flexible and reasonable under the circumstances, and protectively provide augmented disclosure with the assistance of knowledgeable counsel. These types of adverse changes may require a franchisor to amend and redisclose the amendment to an FDD to prospective franchisees (or even recently disclosed franchisees), under federal law and state law (as applicable). The failure to do so may result in a violation that could carry substantial civil liability. See, e.g., NY’s Franchise 200.5(b) (amendments to franchise offering prospectus) (“material change”).

1.9 Are there any other requirements that must be met before a franchise may be offered or sold?

In addition to franchisors’ obligations to comply with the aforementioned franchise disclosure and registration laws, there are other business and legal elements of franchising that the franchisor must address prior to engaging in franchise sales activities.

Trademark registration

As noted in the response to question 1.1 above, the definition of a franchise includes the franchisee’s operation of its business under the franchisor’s trademark. Therefore, franchisors should pursue the federal registration of all trademarks, service marks, trade names, logos, domain names, and other commercial symbols that will be used in connection with the franchise programme with the United States Patent and Trademark Office (“USPTO”). Federal trademark registration confers many benefits on the Franchisor, including but without limitation: (i) protection against infringement in the federal courts; (ii) a presumption of the trademark’s validity; (iii) a valuable, transferrable asset; (iv) notice to potential infringers of the Franchisor’s ownership of the trademark; and (v) prevention of the registration of similar trademarks.

Assumed business name registration

Franchisors should register any assumed or fictitious business names under which they operate with the proper administrative agency, prior to offering and selling franchises, in order to protect their rights to use that particular assumed name.

Copyright protection

Under the 1976 Copyright Act (the “Copyright Act”) (17 U.S.C. §§101 *et seq.*), copyright protection is available for “original works of authorship fixed in any tangible medium of expression”. The Copyright Act broadly protects literary works, musical works, dramatic works, pictorial, graphic and sculptural works, sound recordings, motion pictures and audio-visual works, and architectural works. These categories may be viewed broadly, but also carefully. For example, software code may be registerable even if it is not a “literary work” in the literal sense. On the other hand, a recipe consisting of a mere list of ingredients is not protectable under the Copyright Act. Tradenames, slogans, phrases and logos, all of which are crucial to the franchise model, are generally protected under trademark law but not under the Copyright Act. It is advisable for franchisors to pursue copyright protection where appropriate, because of the relatively low cost of registering copyrights, and the valuable rights provided under the Act, including, but without limitation, the right to pursue statutory damages and attorneys’ fees in federal court.

Advertising materials related to the sale of franchises

Certain registration states, including New York and California, require franchisors to file any materials that advertise the sale of franchises (e.g., brochures and websites) prior to the advertisement’s first publication in that state. New York State, in particular, requires the franchisor to receive approval from the New York State AG’s Office prior to publishing the advertisement.

Registration of franchise brokers and sellers

Certain states require franchisors to register their franchise sellers with the appropriate regulatory agency before that person is permitted to sell franchises or multi-unit development rights in that state. In these states, franchisors must file a Franchise Seller Disclosure Form for each franchise seller, which includes the seller’s name, business address and phone number, his or her employer, title, five-year employment history and information

about certain relevant litigation and bankruptcy matters. Two states (e.g., New York and Washington) require franchise brokers to file a separate registration form that provides the state with more detailed information about the broker. A Franchise Seller Disclosure Form and/or Franchise Broker Registration Form must be submitted with each initial registration application, annual renewal application and any post-amendments to a franchisor's FDD.

1.10 Is membership of any national franchise association mandatory or commercially advisable?

No. While membership in a national franchise association is not mandatory, it is strongly advisable. Many franchisors, individual franchisees and businesses that service the franchising industry are members of the International Franchise Association ("IFA"), which is the largest and oldest global franchising organisation. The IFA provides its members with a wealth of valuable information (including, but not limited to, the latest legal developments affecting the franchising industry, networking platforms and franchise opportunity information) relating to the franchising industry. For information about the IFA, visit their website at: <http://www.franchise.org>. In addition to holding membership in the IFA, many franchisees and franchisee associations are members of the American Association of Franchisees and Dealers ("AAFD"). The AAFD has promulgated a code of Fair Franchising Standards, which sets forth the AAFD's view of requirements for a more "level playing field" between franchisors and franchisees. Visit <https://www.aafd.org> for more information about the AAFD. Both the IFA and the AAFD engage in "lobbying" activities before Congress, with respect to matters such as the FTC Franchise Rule and other franchise-related legislative matters.

1.11 Does membership of a national franchise association impose any additional obligations on franchisors?

The IFA has a Code of Ethics that can be found at <http://www.franchise.org/mission-statement/vision/code-of-ethics>. While it does not have the force or effect of law, this Code of Ethics provides IFA's members with a framework for the manner in which they are to act in their franchise relationships. As mentioned in question 1.10 above, the AAFD has promulgated its code of Fair Franchising Standards, which addresses relationships between franchisors and franchisees and regarding franchising, generally.

1.12 Is there a requirement for franchise documents or disclosure documents to be translated into the local language?

No. Federal and state law only require that the FDD be written in "plain English".

2 Business Organisations Through Which a Franchised Business Can be Carried On

2.1 Are there any foreign investment laws that impose restrictions on non-nationals in respect of the ownership or control of a business in your jurisdiction?

Generally, there are no restrictions relating to foreign investment in a business in the U.S. Such restrictions are contrary

to the general approach to free trade. Typically, countries with developing markets are more likely to impose such "foreign investment" restrictions and regulations. However, the U.S. federal government imposes certain restrictions, including, for example, disclosure filing requirements and/or actual limits on foreign investment that may apply to certain highly regulated sectors and/or sensitive industries or businesses (e.g., communications and broadcasting), especially those that may have a potential impact on national security (e.g., banking, technology, weapons manufacture, maritime, aircraft, energy, etc.). As franchise opportunities in the U.S. do not typically involve these industries or businesses, it is not likely that franchisors will be affected by such restrictions.

2.2 What forms of business entity are typically used by franchisors?

As is frequently the case with other businesses, franchisors operating in the U.S. will typically utilise a corporation or limited liability company ("LLC") as their preferred form of business entity. While each of these entity types offers "limited liability" to its owners, choosing between the two will depend on the legal, financial and tax needs of the franchisor and its principals. If a franchisor chooses to use the corporate form of entity, typically a "C corporation" is used (as opposed to an "S corporation", which is most often used in connection with small, closely held businesses, such as those formed by franchisees. It is important to note that foreign investors are prohibited from being owners of S corporations.) In a C corporation, income that is received by the company is taxed at the entity level. Then, the company's profits are taxed (again), to the company's shareholders when distributions are made. However, over the last 20 years many franchisors have chosen to use the LLC as their preferred type of business entity for their business structure, rather than utilising a corporate structure. LLCs offer franchisors greater flexibility in certain areas, including with respect to internal governance requirements (e.g., fewer "corporate" formalities in management structure and activities, and fewer ownership restrictions), income allocation and the ability to transfer assets out of the entity. Since LLCs are usually treated as "pass through" entities for tax purposes, the entity's profits are not taxed at the business level. Rather, the profits typically flow through to the company's owners in proportion to their ownership percentage. The owners pay taxes on this income as part of their taxable income. An LLC may, however, elect to be treated as a C corporation for tax purposes.

While foreign franchisors are permitted to sell directly to prospective franchisees located within the U.S., foreign franchisors typically use one or more affiliate or subsidiary entities to conduct their U.S. operations. However, if a U.S. franchisor is a wholly owned subsidiary of a foreign parent, then certain financial disclosures regarding the foreign parent must also be included in the U.S. franchisor's "offering prospectus" (the FDD), which must be given to all prospective franchisees. Usually, franchisors (including foreign franchisors) find it useful to utilise a tiered "corporate" structure comprising a holding company or "parent" company at the "top" and several subsidiary operating entities, "below" the holding company. (This "corporate" structure approach may be used for LLCs as well as corporations.) For example, one subsidiary may own the intellectual property rights (typically, trademarks or service marks) associated with the franchise system; another subsidiary might be the "franchisor entity", which would enter into the franchise agreement (and other agreements) with franchisees; another subsidiary might be a management company, which would

provide the various “franchisor services” to the franchisees; and yet another subsidiary could purchase, sell or lease equipment to franchised or company-owned units. Typically, separate entities are also formed in order to hold title to each parcel of real estate that is owned by the franchisor or its affiliates. Where the franchisor subleases the various premises to its franchisees, the franchisor may choose to form separate entities to enter into each “master-lease” with the landlord rather than have one real estate “leasing entity”. This provides the franchisor (and its affiliates) with greater asset protection and additional flexibility in the event that it wanted to sell or transfer a particular parcel of real estate.

Many franchisors, including foreign franchisors, do not rely solely on selling single unit franchises. In international franchising, franchisors typically establish a franchise network by utilising either (or sometimes both) the master franchise (or Sub-Franchisor) method and/or the area development method. The more common approach in international franchising in the U.S. is the master franchise method, where the Master Franchisee is granted the right to either develop the assigned territory itself or to sub-franchise the territory to other franchisees, with the Master Franchisee usually taking on “franchisor” obligations (e.g., providing initial training and ongoing support and guidance) and typically receiving a significant share of the initial franchise fees and ongoing royalty payments paid by the franchisees within the territory. Alternatively, some franchisors, who wish to retain more control over their franchise network and do not wish to share their initial franchise fees and ongoing royalty fees with a Master Franchisee, will grant territories to “area developers” who obligate themselves to develop their territory, but have no rights to offer sub-franchises to other franchisees. Since the U.S. is a large country with varying demographics and diverse cultures, franchisors often utilise a combination of the master franchise and area development franchise arrangements to expand their franchise network. Another option is for the franchisor to enter into a “joint venture” with an independent company, presumably, a joint venture partner located in the U.S. Such a partner may have significant experience in operating franchises or the ability to provide significant financial resources to the franchise system, or perhaps both. However, the “joint venture” approach has not been frequently utilised by franchisors (including foreign franchisors). Potential disadvantages of joint ventures include, among others: (i) the risk of ineffective management and/or disagreements with the partner; (ii) requiring a large investment; and (iii) the sharing of initial and ongoing fees, profits and other benefits.

2.3 Are there any registration requirements or other formalities applicable to a new business entity as a pre-condition to being able to trade in your jurisdiction?

In the U.S., new business entities are formed under state law and their formation documents (e.g., for corporations: the Certificate of Incorporation; and for LLCs: the Articles of Organisation) are filed with the Secretary of State (or similar agency) in the state of formation. (In a small number of states, there are publication requirements for new business entities, most notably in New York with respect to LLCs, limited liability partnerships (“LLPs”) and limited partnerships (“LPs”).) Any new business entity formed in the U.S. is required to obtain a federal taxpayer identification number by filing Form SS-4 with the Internal Revenue Service. Pursuant to said form, a “responsible party” must be identified, who is required to be a natural person and not another entity, and who is the person who exercises ultimate effective control over the entity. If the new entity will be conducting business in multiple states, it will likely have to file

an application in each state (other than the state of formation) in order to qualify to “do business”. In each state where the entity is authorised to “do business”, it must list a designated “registered agent” (who resides in the state, in the case of an individual; or which has a physical location in the state, in the case of a business entity), upon whom service of process (e.g., lawsuit documents) may be served.

New entities must also register as an employer with the department of labour of the formation state and must withhold proper amounts of certain taxes including, for example, income taxes and Federal Insurance Contribution Act (“FICA”) taxes (which include contributions to federal Social Security and Medicare programmes). A handful of states require the filing of initial reports and tax forms rather than waiting to file an annual report. Finally, entities that are involved in certain specific industries or types of businesses (e.g., education/school-based, childcare-based businesses, or businesses selling alcohol to the public) may have to obtain one or more licences or permits in order to comply with state or local laws.

3 Competition Law

3.1 Provide an overview of the competition laws that apply to the offer and sale of franchises.

In the U.S., “competition law” is generally referred to as “antitrust law”. In contrast to other jurisdictions, such as the E.U., “antitrust” laws do not directly regulate the offer and sale of franchises. Rather, the FTC Franchise Rule (16 C.F.R. 436 *et seq.*), and statutes in certain states (such as NYFSA (N.Y. G.B.L. § 680 *et seq.*) or California’s Franchise Investment Law (CA Corp. Code §31000 *et seq.*)), directly regulate the required disclosures and sales practices with respect to the offer and sale of franchises (discussed in detail in section 1, above). However, these are not generally considered “antitrust” or “competition” laws in the U.S.

Nonetheless, despite not directly regulating the sale of franchises, there are “antitrust” laws that do impact upon the franchise relationship that apply in the U.S. On the federal level, the major antitrust statutes that may apply to franchising are the Sherman Act, (15 U.S.C. §1 *et seq.*) (generally prohibiting anti-competitive or monopolistic conduct), the Clayton Antitrust Act (15 U.S.C. §§12 *et seq.*) and the Robinson-Patman Act (at 15 U.S.C. §13) (generally prohibiting anti-competitive price discrimination, exclusive dealing, and tying). The Antitrust Division of the U.S. Dept. of Justice (“DOJ”) and the FTC cooperate to enforce the federal antitrust laws, while the Clayton Act authorises private rights of action. In addition, almost every state in the U.S. has enacted its own antitrust laws, which are usually based upon, but may differ from, the federal antitrust statutes. Therefore, while these state statutes may be similar, and usually look to federal law for guidance, practitioners need to examine both the federal and state laws in the applicable jurisdiction in order to avoid any potential issues.

For many years, antitrust in the franchise context has been relatively inactive, as courts had significantly limited the applicability of antitrust laws in the franchise context. However, this area may be entering an era of increased regulation and activity. There has been an increased scrutiny by regulators of “no-poach” provisions; see question 3.6 below. Further, there are a number of legislative initiatives, including the Competition and Antitrust Law Enforcement Reform Act (“CALERA”), and other bills being introduced, which, if passed, could dramatically alter the antitrust landscape, including for franchising. Previously, most antitrust claims, such as franchisee complaints of price-fixing (e.g., franchisors setting maximum or minimum

prices), exclusive dealing requirements (e.g., requiring franchisees to deal only with particular designated vendors or suppliers), or tying (e.g., requiring that franchisees purchase products or services not directly related to the trademarked franchised product or service), had dramatically fallen in the last two decades after court decisions curtailed their applicability in the franchise context. Many courts had narrowly restricted the definition of the applicable “market” for antitrust analysis in ways that effectively exclude franchise relationships. In addition, courts now generally employ the “rule of reason” test in circumstances that would once have been considered to be *per se* violations of antitrust laws. As such, in most franchise circumstances, a franchise agreement that clearly provides for (and an FDD that adequately discloses) contractual requirements to purchase certain goods or services, restraints on a franchisee’s ability to freely conduct business, or requirements that franchisees deal only with specific vendors, will defeat most antitrust claims. It currently remains the case that franchisors who comply with all applicable disclosure requirements, and properly detail any potentially anti-competitive aspects of the franchise relationship within the FDD (e.g., specific suppliers that must be used), can significantly lessen any potential liability for antitrust issues with their franchisees in the context of the offer or sale of the franchise.

However, if CALERA in some form, or one of several similar bills passes, not only will that potentially provide funding for increased enforcement and regulatory resources (including the FTC and DOJ), but also potentially alter some of the factors considered by courts, and add additional legislation to curb “exclusionary conduct” by “dominant companies”. As such, additional federal regulation may be on the horizon, and if passed, it is difficult to predict how franchised system models will be impacted, and traditionally vexing areas such as tying, price fixing, and exclusive dealing, may once again be the focus of increased litigation and scrutiny.

In addition, AGs are also still aggressively reviewing “anti-poach” provisions, and there may be state-specific antitrust legislative action to be aware of. One particular state’s bill that could impact antitrust, is New York’s “Twenty-First Century Anti-Trust Act”, which has now passed the New York Senate, and could significantly broaden antitrust regulation under New York’s Donnelly Act by, *inter alia*, making it far easier to evince a company has a “dominant position” in its “relevant market”, remove the requirement that a “relevant market” be shown, and eliminate the consideration of balancing “pro-competitive” effects of such conduct (such as the benefits of a franchised business model). If such prospective legislation is not carefully crafted, or does not contain sufficient carve-outs for franchising, it has the potential in the franchise context to upset traditionally permitted contractual terms, such as: (1) restrictive covenants and other employee restrictions, which arguably are actually protective of franchisees in many ways; (2) permissible and disclosed price setting; or (3) tying and the required use of approved vendors or suppliers, which is often necessary to maintain franchise system standards, or create uniformity in a franchise system. If consideration of the benefits of franchising are stripped from a court’s analysis, this prospective legislation could have a significant disproportionate impact on the unique situation presented by franchised businesses. This is an area where franchise counsel may need to adapt in the event any of these legislative initiatives are successful, and do not address the impact it may have on franchised businesses.

Notably, there may be circumstances where an offer or sale of a franchise constitutes an “unfair” or “deceptive” act or practice, under either federal law or an analogous state law. The federal FTC is responsible for consumer protection enforcement for over 70 different laws, including the FTC Act, which contains

a broad prohibition against “unfair and deceptive acts or practices”. See, e.g., §15 U.S.C. 45 (“Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful”). Many states have also enacted similar statutory schemes prohibiting unfair or deceptive trade practices (Little FTC Acts), many of which provide for a private right of action.

3.2 Is there a maximum permitted term for a franchise agreement?

No. There is no federal regulation of the maximum permitted term for a franchise agreement. However, there is wide variation with respect to the enforceability of unlimited terms in specific states. Some states may be reluctant to enforce franchise agreements without a limited term. This may apply to franchise agreements without a specified duration, or to automatic renewal agreements that continue in perpetuity (for example, an agreement that renews automatically every 10 years without any limit). On the other end of the spectrum, the New Jersey Franchise Practices Act (NJ Stat. 56:10-1 *et seq.*) requires a franchisor to automatically renew a franchise agreement, regardless of the stated term in the agreement, so long as a franchisee is in substantial compliance with the franchise agreement. Again, the franchise practitioner is well advised to review all applicable state laws in addition to federal law in connection with this issue.

3.3 Is there a maximum permitted term for any related product supply agreement?

No. As noted above, there are some states that may be hostile to enforcing agreements without any stated term, but there is no antitrust statutory restriction. The FDD must adequately disclose any required related product supply agreements, and the franchise agreement must clearly provide for it. In addition, there may be circumstances where, for example, a supply agreement becomes so onerous that it may excuse performance, violate a state statute, or give rise to a claim, so that its enforcement becomes unreasonable (such as the New Jersey Franchise Practices Act, which makes it unlawful “to impose unreasonable standards of performance upon a franchisee”, see NJ Stat. §56:10-7(e)).

3.4 Are there restrictions on the ability of the franchisor to impose minimum resale prices?

Federal antitrust law will prohibit the use of a minimum resale price (“MRP”) if the MRP causes an adverse effect on *inter-brand* competition under a “rule of reason” test (if it results in an unreasonable restraint of trade *concerning competitors*, based upon economic factors). Therefore, under federal law, MRPs are permitted, and courts have been reluctant to find violations where there is an economic justification for them, resulting in most cases being dismissed. However, there are state statutes that differ from the federal standard, and that prohibit the use of MRPs. Indeed, while federal law has generally adopted a “rule of reason” standard, state statutes may still consider MRPs to be *per se* unreasonable restraints of trade, instead of analysing them under the more permissive “rule of reason” test (e.g., CA and NY still have *per se* prohibitions against MRPs, even if they may not be aggressively enforcing them). This area of law is continuing to develop, and state laws may ultimately gravitate towards adopting the federal “rule of reason” analysis, but until those laws change, there is no guarantee that a MRP will be permitted.

In addition, while not an “antitrust” issue, MRPs may give rise to other claims by franchisees, such as common law claims for violation of the implied covenant of good faith and fair dealing, or NJ’s prohibition against imposing “unreasonable standards of performance” upon franchisees (NJ Stat. §56:10-7(c)). The Robinson-Patman Act is another antitrust law that can impact a franchisor’s ability to set pricing. A franchisor should be wary of differentiating between certain franchisees, or groups of franchisees, in its pricing of required goods or services, as favoritism to certain franchisees may constitute violations of the Robinson-Patman Act (15 U.S.C. §13) (anti-competitive price discrimination).

Franchisors should retain competent counsel if they wish to mandate MRPs, especially if they have franchisees in states where *per se* prohibitions exist against MRPs. Assuming it is permissible in all the applicable states, if a franchisor must implement a MRP or system-wide promotion, best practices would suggest at the minimum that such a MRP be franchisor driven, be consistent with the franchise agreement and FDD, be based upon a defensible business rationale that demonstrates that the pricing would encourage market competition, not suppress it (preferably after testing or market research is conducted), and have a benefit to the “consumer”. Notably, MRPs are not the exclusive mechanism to induce franchisees within a system to maintain minimum pricing. Other alternatives such as minimum *advertised* price (“MAP”), or rewards or inducements for franchisees who choose to participate in a non-mandatory minimum price, can be utilised. However, such programmes come with their own perils, and if not properly implemented, could lead to anti-competitive liability in their own right.

3.5 Encroachment – are there any minimum obligations that a franchisor must observe when offering franchises in adjoining territories?

In general, federal antitrust laws do not require a franchisor to observe any minimum obligations when offering franchises in adjoining territories (or, for that matter, even when a franchisor itself operates in an adjoining territory). The FTC Franchise Rule does mandate that an FDD includes a detailed disclosure of the rights conferred in any territorial grant, but there are no required obligations (other than those that, typically, are provided by the agreement between the parties). Franchisees will find it difficult to bring antitrust claims on this basis, as the antitrust laws will generally not consider the applicable “market” for antitrust analysis to be competing franchise locations, but rather the market for franchises generally, when the franchisee purchased the franchise. Further, there will generally be sufficient justification for “territory” competition under the “rule of reason” analysis to avoid liability under the federal antitrust laws. However, anti-competitive misconduct on the part of a franchisor that impacts *inter-brand* competitors could still result in liability, and more restrictive state antitrust statutes may also impose liability for anti-competitive conduct within a particular jurisdiction.

Although there is no specific federal minimum obligation with respect to the territorial rights of franchisees, encroachment or the unfair allocation of territories could lead to liability outside of antitrust law (*discussed infra*), such as for violation of the implied covenant of “good faith and fair dealing”, which many states automatically incorporate, by law, into every contract. In addition, certain state franchising statutes may restrict or prohibit unfair encroachment activity (see, e.g., Minnesota’s Franchise Statute, MN Stat. §80C.14; and Rule 2860.4400, Unfair and Inequitable Practices).

What many franchise practitioners consider to be the “bottom line” in this regard is that the provisions in the franchise

agreement (and the disclosures in the FDD) that address and define the franchisor’s right to sell franchises (or operate branded units itself) in a franchisee’s “protected territory” must be crafted with great care. Franchisors are well advised to give thought not merely to geographical limits, but also to the applicable “market” of customers to which a franchisee will be selling its goods and services. Indeed, encroachment issues now also encompass non-traditional methods of providing products and services in competition with a franchisee, such as through e-commerce, or the use of non-traditional sales-points, such as food trucks, kiosks or promotional activity within a territory of a franchisee. Healthy franchise systems should take steps to ensure that each franchised business has a sufficient “market” of customers to remain viable and profitable, as that not only minimises the potential for litigation, but also ultimately is in the best interests of both the franchisor, and its individual franchisees.

3.6 Are in-term and post-term non-compete and non-solicitation of customers covenants enforceable?

Under federal antitrust law, in-term and post-term non-compete clauses (with respect to franchisees) and non-solicitation of customer provisions are generally enforceable, and there is no *per se* prohibition against them. However, that is not dispositive, as the enforceability of these contract terms depends largely on state law. Some states may prohibit or severely restrict post-termination non-competition clauses. California law, for example, generally voids any post-termination non-competition clauses (see, e.g., CA B&P Code §§16600 *et seq.*). In states that restrict non-solicitation and non-compete clauses, enforceability often depends upon factors bearing upon the reasonableness of the restriction, including whether it is necessary to protect legitimate business interests, whether the restriction is contrary to the public interest, and whether it is reasonable in geographic scope, the scope of business activity being restricted, and the duration of the restriction. For example, a post-term restrictive covenant that only restricts certain activities in direct competition with the franchisor in a small geographic area, for one year, is far more likely to be enforceable than a broad covenant seeking to completely restrain a former franchisee from engaging in a wide range of activities in a large area for many years. In addition, franchise counsel should carefully examine the “choice of law” applicable to a particular agreement or to disputes arising therefrom, as many states do not allow their non-competition statutory provisions to be waived (regardless of what the “choice of law” clause may state in an agreement), and there is significant variation among jurisdictions as to the enforceability of the non-compete and non-solicitation clauses typically provided for in franchise agreements.

One important exception is “no-poach” agreements, which are non-compete clauses that apply to a franchisee’s employees (e.g., prohibiting one franchisee’s employees from being “recruited” to be employed by another franchisee). These provisions were often included specifically for the benefit of franchisees within a system, because they allowed a franchisee to train critical employees or managers without fear that another franchisee could swoop in and poach such an individual after significant resources had been expended in training them. However, franchisors now find themselves the subject of scrutiny by regulators for including such provisions, despite their pro-franchisee protections, and pro-competitive nature in allowing for training and investment in training of critical employees by franchisees without fear of them being poached. In short, the franchise system of business does not fit well within the recent regulatory attack generally on “no-poach” provisions, and franchise systems are being forced to adapt.

This continues to be one of the “hottest topics” in franchise competition law, and in the past few years “no-poach” agreements have come under increased scrutiny from federal and state regulators, including the federal DOJ and the FTC, and pose a significant litigation risk (as, for example, they may violate the Sherman Act). On July 9, 2021, the Biden Administration issued an Executive Order “Promoting Competition in the American Economy”, which, *inter alia*, took aim at restrictive covenants in employment, including anti-poaching clauses. As of April 2018, the DOJ already had issued a policy update specifically warning the public of its intent to aggressively enforce antitrust laws in relation to labour markets and “no-poach” provisions, and appears to be doing just that, now with enhanced regulatory activity under the Biden Administration. Indeed, where prior actions had been limited to the healthcare industry, it is apparent that the DOJ is now investigating and prosecuting no-poach actions in other sectors (see *United States v. Mahesh Patel, et al.*, No. 3:21-cr-00220-VAB, December 15, 2021). The DOJ is clearly engaged in increased resource allocation and scrutiny, as well as a policy shift as to the applicable legal standard (advocating for no-poach provisions to be considered “*per se*” violations as opposed to being analysed under a “rule of reason” analysis). Recently, in *Deslandes v. McDonald’s USA, LLC*, the DOJ submitted a “statement of interest”, ultimately rejected as untimely by the court, arguing for rejection of the more permissible “rule of reason” test and arguing for “*per se*” violations, even though it had recently argued for a “rule of reason” approach in 2019 (see *Deslandes et al. v. McDonald’s USA, LLC, et al.*, 1:17-cv-04857 (N.D. Ill. Jul. 28, 2021) (*cf. Stigar v. Dough Dough, Inc.*, 18-cv-0244-SAB, Dkt. 34 (E.D. Wash. March 8, 2019)). Further, several states’ AG’s Offices have aggressively pursued state “no-poach” regulations under state antitrust laws (notably CA under its Cartwright Act, and WA under its Consumer Protection Act), also generally seeking to take a “*per se*” violation approach.

Most cases will depend upon which standard is adopted under a particular federal or state (or local) statute, and the determination of whether restraints are deemed to be “vertical” or “horizontal”. A case is likely to turn upon whether under the particular circumstances, local caselaw, or statute involved, a strict “*per se*” standard, a “rule of reason” standard, or a “quick look” (a truncated “rule of reason” test) is used. See, e.g., *Stigar v. Dough Dough, Inc.*, Index No. 18-CV-0244 (E.D. Wash. Aug. 3, 2018) (for an informative deliberation of the various standards where a franchisee sued under the Sherman Act and WA CPA) (DOJ and WA AG’s Office filed Amicus Briefs) (ultimately settled prior to determination).

At present, federal law remains unsettled, and different federal courts have adopted different tests. State statutes differ markedly as well, and aggressive state regulators have been prosecuting cases under state law arguing a “*per se*” rule should be applied, independent of the federal anti-competition laws. See, e.g., *Washington v. Jersey Mike’s Franchise Systems, Inc.*, No. 18-2-25822-7(SEA) (arguing *per se* rule generally under WA CPA). See also *Pittsburgh Logistics Sys. v. Beemac Trucking, LLC*, 249 A3d 918 (PA 2021) (discussing “no-poach” clauses and refusing to adopt *per se* rule, but only allowing for narrowly tailored usage). There are also legislative efforts being made at the federal level, and within multiple states, to pass laws further prohibiting restraints upon employment and poaching. Given the uncertainty of this area, and the potential civil liability and criminal violations, franchisors should proceed with caution.

In response to regulatory actions, and private class actions, many major franchise systems have entered into consent decrees or unilaterally agreed to change their restrictive covenants so as to avoid enforcement action by regulators and litigation exposure. Of course, the primary victim of this is franchisees, who are

trying to protect their investment in training critical employees. Franchisors who seek to utilise “no-poach” restraints may be exposing themselves to significant liability and regulatory risk, and need to exercise caution in doing so. Franchisors should particularly avoid making any “no-poach” agreements with other franchisors within the same industry, as those will likely be considered “horizontal” and violate federal and state law, and might even result in criminal prosecution. Franchisors and franchisees should shy away from “no-poach” provisions where they may compete for the same employees, especially in the context where franchisors may have company-owned units in the same market. If a “no-poach” agreement is to be used at all, franchise systems should be prepared to argue its economic benefits and necessity, try and ensure it is in a jurisdiction that adopts a “rule of reason approach”, and narrowly tailor any restrictions (and document the justification for such restriction in advance). Regardless, if a local law is hostile to, or bans “no-poach” provisions outright in a particular jurisdiction, they should be avoided altogether. Many franchise systems have already concluded that “no-poach” provisions are just not worth the risk and effort that is likely to result from their utilisation.

4 Protecting the Brand and Other Intellectual Property

4.1 How are trade marks protected?

At the international level, the U.S. is a party to the Paris Convention and Madrid Protocol (administered by the World Intellectual Property Organization (“WIPO”)), which allows a trademark to be registered internationally with member nations through a uniform process (an “International Application”). Generally, under the Madrid Protocol, a trademark must first be registered “locally” in a member nation (the “Office of Origin”), approved, and then submitted to the WIPO for international approval and registration (within 12 or 18 months). Once approved at the WIPO level, the mark may be submitted to the other member nations in which the mark holder seeks to obtain trademark protection. When an international mark holder seeks approval of an international trademark within U.S. (through the Madrid Protocol, often called a “Madrid application” or “Section 66(a) Application”), the application is submitted to the USPTO. The application will then be examined by the USPTO, in the same manner, and subject to the same standards, as a mark seeking approval within the U.S. The international mark must be approved by the USPTO before it is allowed to be registered within the U.S. In 2022, the WIPO issued a revised “Guide to the Internal Registration of Marks under the Madrid Protocol”, which is an excellent guide for navigating the registration process. Notably, the WIPO also provides for ADR through its WIPO “Arbitration and Mediation Center”, and franchisors are well advised to consider that forum for dispute resolution, should a dispute arise.

In the U.S., at the federal level, the USPTO is the agency responsible for registering trademarks. Unique logos or designs a franchisor wishes to use in connection with their mark can, and should, also be registered with the USPTO. Applicants can file online with the USPTO and should regularly check the online monitoring system throughout the process. The USPTO will initially determine if the application has met the minimum filing requirements. If so, it will assign an examining attorney to review the application and determine if any conflicting marks or other defects in the application prevent the application from being granted (this review by the examining attorney generally takes several months). If an issue with the application arises,

and the examining attorney decides the mark should not be registered, the USPTO will issue a letter explaining the reason for refusal or deficiency (an “Office Action”), and the applicant must respond (a “Response to an Office Action”) within six months, or the mark will be deemed to have been “abandoned”. If the examining attorney approves the mark, or the application overcomes an Office Action, the USPTO will “publish” the mark in the USPTO’s weekly “Official Gazette”, and anyone wishing to challenge it will have 30 days from the date of publication to do so. Objections are heard by an administrative tribunal within the USPTO called the Trademark Trial and Appeal Board (“TTAB”). If no objection is filed, or none are successful, the registration process (which differs slightly if the mark is currently “in use” or not) then continues to formal “registration”, which can take several more months. If the mark is not actively “in use”, the registrant must, after receiving a “notice of allowance”, use the mark in commerce and submit a “Statement of Use” to the USPTO (or request an extension). If an application is refused by the examining attorney, or fails to overcome any objections, there is an appeals process to the TTAB. Recent legislation, the Trademark Modernization Act (“TMA”), became effective on December 18, 2021. The TMA has expedited and simplified the process for removal of unused (or abandoned) trademarks, even by *ex parte* practice (both for expungement, and for re-examination). The TMA further codified the “letter of protest practice”, whereby interested third parties could challenge a registration, making it easier to challenge an unused mark. The TMA also expedites the registration process (e.g., by shortening the response period for office actions (effective after December 27, 2021).

After a federal trademark is registered, the registrant must, periodically, take steps to renew the mark, and file “maintenance” documents, or risk cancellation. Significantly, a “declaration of use” must be filed between five and six years following registration, and a renewal application must be filed 10 years following registration, and every 10 years thereafter (internationally filed marks under the Madrid Protocol follow a slightly different process). Again, with the passage of the TMA, mark holders must remember to be vigilant, as the process for removal or expungement of an “unused” mark, has been simplified, and even well-intending franchisors who have suffered a delay in implementation of a new mark or system (e.g., due to COVID-19 or supply chain-related issues), may need to take steps to ensure timely “use” of their mark. Franchisors should take care to avoid having another party cancel, and even acquire, the mark they wanted to use. Further, the issue of what constitutes “use” or “use in commerce”, for foreign trademark holders to qualify for protection, can be particularly tricky to navigate, and mere “spillover” of international business operations into the U.S., or occasional use, may not be sufficiently protective, if a properly registered mark is not being used actively in U.S.-based Operations (within the U.S.). Specific acts or affirmative steps may be necessary by an internationally based franchisor to further protect that mark (such as to affirmatively utilise a U.S.-based agent to promote or provide services connected with a mark). Knowledgeable counsel should be consulted if this is a significant risk.

Individual states also have their own trademark registration offices (with their own registration process). While individual state registration is better than either not registering, or relying upon common law trademark rights (discussed below), franchisors are well advised to seek federal registration of their mark(s).

Significantly, in the U.S., unlike in many jurisdictions, a party can also establish and acquire “common law” trademark rights through the usage of a mark in commerce. Common law rights to a mark may be superior to another party’s attempt to subsequently register the same or a similar mark, especially if the

common law mark is in use prior to the other party’s filing for registration, and the holder of the common law mark objects properly. However, common law rights are not well defined and are often limited by geographic scope and specific industries or markets. Indeed, recent decisions, as well as established jurisprudence, tend to significantly limit such common law marks to the specific geographic market in which they are known or “famous” – meaning that reliance on a common law mark may limit the first-in-time mark holder to a small geographic territory (such as a city), while a later, federal USPTO registrant, may have the rest of the country to operate in.

Therefore, while trademarks do not have to be registered to obtain “common law” rights, franchisors are well advised to proceed with, and complete, the federal trademark registration process with the USPTO (outlined above), as a federally registered trademark acts as a “notice to the public” of the franchisor’s claim on the mark and creates a legal presumption of nationwide ownership and the exclusive right to use the mark (in connection with the goods or services in the registration). Federal law, including the Lanham Act (15 U.S.C. §1051 *et seq.*), also grants significant legal remedies for federally registered marks (including, under certain circumstances, injunctive relief, treble damages and attorneys’ fees). Further, once registered, the federal mark holder has a presumptive argument that it was “first in time” as of its registration (since all objections will either have been rejected or deemed untimely). After federal trademark protection is granted, an adverse “common law” mark holder will be extremely unlikely to overcome the protection of the federal registration. Indeed, the TMA recently resolved an unsettled trademark issue caused by the U.S. Sup. Ct. decision *eBay Inc. v. MercExchange*. 547 U.S. 388 (2006), by codifying that mark holders have been presumptively irreparably harmed by a violation, removing a significant barrier to obtaining an injunction. Trademark infringement actions can also be brought to address online violations, including unauthorised usage of a trademark in a domain name (or “cybersquatting”), by initiating actions under the Lanham Act (as amended by the Anti-Cybersquatting Piracy Act), or initiating an arbitration proceeding to seize the offending domain under the Internet Corporation for Assigned Names and Numbers (“ICANN”) Uniform Domain-Name Dispute-Resolution Policy (“UDRP”) procedure, or, if applicable, ICANN’s newly adopted Uniform Rapid Suspension (“URS”) domain name suspension procedure for “top down” domain names.

A trademark holder in the U.S. is generally required to “police” its mark, by actively monitoring the market in order to discover infringement, and then to take action against infringers so as to protect its mark. A franchisor who fails to take timely action against infringers may lose its right to obtain any relief (due to, *inter alia*, affirmative defences of laches, acquiescence or waiver, a finding of abandonment, or where usage of the mark by others causes the mark to lose its distinctive significance). Once it has been established that a franchisor has not properly policed its mark in one instance, subsequent attempts to enforce a mark may become much more difficult, or impossible. Constant vigilance is required.

Unfortunately, the question of “protecting” a mark also goes beyond legal protections. A franchisor must also constantly “police” its mark and brand reputation, not just to protect against infringement, but also to ensure that consumers see it in a positive light. The franchisor must therefore keep apprised of online and social media commentary on the mark, and aggressively work with its franchisees to address negative comments and adverse online postings. Culturally, the U.S. is quite diverse, and regional and political differences vary significantly from market to market. It may be necessary for a franchisor to be flexible in its

political positioning (or neutrality) to facilitate operations for individual franchisee's local political environments, and Franchisors may need to tailor their approach on a regional level to avoid negative impacts upon brand image depending on the specific region. Franchisors must stay ahead of any potentially concerning situation with effective PR, so the brand can protect its marks from any negative social media, and such services are often relatively inexpensive compared to the potential business-ending cost in failing to properly handle a PR issue. Even smaller franchisors should have contingency plans and systems for addressing problems in place, so they will be able to identify any threat, respond properly, and recognise that regional differences may necessitate a nuanced approach. The new reality of social media, and the ability for any negative situation to rapidly reach large segments of the population through non-traditional media, means that franchisor must be able to maintain a presence on a wide variety of social media platforms, and be prepared to react swiftly and adeptly to threats as they manifest.

4.2 Are know-how, trade secrets and other business-critical confidential information (e.g. the Operations Manual) protected by local law?

Confidential information, which can include know-how, trade secrets, and other business-critical information, may be protected by federal and state statutes, as well as common law.

The Defend Trade Secrets Act of 2016, 18 U.S.C. §1831 *et seq.* (the “DTSA”) now provides federal protection for trade secrets and creates a private civil right of action for theft or misappropriation of trade secrets (which may be brought in federal court), under which an aggrieved party can seek damages, and for wilful and malicious violation, double damages and attorneys’ fees. Under the DTSA, a party must have provided certain “notice” (under 18 U.S.C. §1833(b)(3)) to any person it wishes to prohibit from disclosing the trade secret(s), including employees, agents, or franchisees, if it wishes to later take advantage of the DTSA’s potential award of exemplary damages or attorneys’ fees. Therefore franchisors (and franchisees) should incorporate into their agreements, policy manuals, confidentiality agreements, and other confidentiality provisions, such “notice”. Under the DTSA, a party may also seek injunctive relief, including an *ex parte* expedited seizure of the trade secret under certain circumstances. See 18 U.S.C. §1836. Importantly for foreign parties (or in connection with agreements with foreign parties), the DTSA also may provide for extra-jurisdictional liability (reaching violators outside of the U.S.). See 18 U.S.C. §1837. Franchisors are already taking advantage of this new weapon in their arsenal to restrain former franchisees from misappropriating trade secrets, and in order to protect the franchisor’s intellectual property. See, e.g., *Panera, LLC v. Nettles and Papa John’s Int’l, Inc.*, 4:16-cv-1181-JAR, 2016 WL 4124144 (E.D. Mo. 2016) (franchisor successfully obtained a temporary restraining order against a former employee to prevent dissemination of trade secrets under the DTSA); *Bambu Franchising v. Nguyen*, 5:21-cv-00512-EJD, 2021 US Dist. LEXIS 88030 (ND Cal May 7, 2021) (franchisor granted injunctive relief for *inter alia* violation of the DTSA). However, simply stating in a franchise agreement that something is a trade secret, does not make it one. Courts will examine carefully whether a franchisor has taken reasonable measures to keep a trade secret “confidential”, and whether the information really is a trade secret not readily ascertainable through independent means, or available as general knowledge in the industry. See, e.g., *Oakwood Labs. LLC v. Thanoo*, 999 F.3d 892 (3d Cir. 2021) Therefore, while the new DTSA may be appealing to franchisors as a potential weapon against former franchisees absconding with

secrets, it is not entirely without peril, as franchisors should take care not to litigate weaker cases, and inadvertently have a court declare that its intellectual property is not sufficiently protected as a “trade secret”, which could have system-wide implications. Overly protective contractual draftsmanship may lead to definitions of a “trade secret” or “confidential information” within a FA that exceeds what is actually protectable under the DTSA. Franchisors should be aware that contractual breaches for what constitutes protected information do not necessarily equate to statutory violations of the DTSA, and they should only bring suit under the DTSA statute when there is a viable claim.

Another form of protection for trade secrets are state-specific statutes. Almost every state (NY being a notable exception) has adopted some form of the Uniform Trade Secret Act (“UTSA”). In addition, each state (including NY) has its own common law trade secret protection, which operates in addition to protections at the federal level. There is variation between specific states, but typically, a party must show that information it seeks to protect is, indeed, “secret”, and not in the public sphere or known by others. A party must also have also taken significant efforts to maintain the secrecy of its trade secrets in order to be afforded common law or statutory protection. Franchisors should therefore implement policies and procedures designed to protect against the dissemination of confidential information. Where applicable, franchisors should require franchisees to agree to non-disclosure agreements, and should include strong and inclusive confidentiality provisions in their franchise agreements. Franchisors should also mandate that their franchisees require that their own respective agents or employees agree to confidentiality prior to disseminating any of the franchisor’s trade secrets. Franchisors should also consider utilising other security measures, including password-protected computer systems, so as to maintain the “confidentiality” of information (such as client or customer lists and information) that the franchisor may wish to keep “confidential”. Franchisors should also be wary in their sales process (e.g., Zoom calls or even “discovery day”) to adequately define the line between a pitch to prospective franchisees, and inadvertently disclosing intellectual property that they want to protect, as prospective franchisees are generally not bound by NDAs, and such conduct by a franchisor will likely result in the information being unprotected. See, e.g., *Smash Franchise Partners, LLC v. Kanda Holdings, Inc.*, 2020 Del. Ch. LEXIS 263, No. 2020-0302-JTL (Ch August 13, 2020) (information was freely shared with prospective franchisees, including on phone calls with prospective franchisees, in pitch-decks, in group calls (without security measures or NDAs), and in the FDD, and therefore was not protectable as a “trade secret”, and was not properly protected as “confidential” information by the franchisor); franchisors should also be vigilant after termination of a franchise, and ensure that not only physical (paper) manuals and trade secrets are returned or destroyed, but also all online access to trade secrets or confidential information is terminated. See, e.g., *Neighborhood Networks Publishing, Inc. v. Lyles*, 19-cv-89-BO (EDNC January 31, 2021) the (franchisor failed to take reasonable steps to protect trade secrets by continuing to allow terminated franchisee access to a web-portal months after termination, making the misappropriation claim unviable).

Courts will generally enforce confidentiality agreements and will grant injunctive relief in appropriate circumstances to prevent the theft or misuse of confidential information. Therefore, well-crafted franchise agreements will often include injunctive relief provisions designed to facilitate the protection of confidential information in court. New or prospective franchisors should be extremely mindful of confidentiality issues before discussing their “new concept”, their “secret sauce”, or

other intellectual property with anyone (including potential investors or prospective business partners). Non-disclosure agreements should be entered into prior to having discussions in which a prospective franchisor has disclosed a trade secret or idea that is unique and worth protecting. In addition, a well-crafted franchise agreement will ensure any “inventions” by a franchisee belong to the franchisor.

Publications by the franchisor, including operations manuals and policy and procedure manuals, may also be protected by federal copyright law (discussed below). In addition, a franchisor might consider applying for a federal patent with the USPTO if a franchisor has a unique invention or product, process, or design. However, confidential trade secrets can be kept in perpetuity, while patents expire. Further, in applying for a patent, a company risks publication of its intellectual property, as patents are public; and worse, if a patent application is rejected, it is typically publicly available within 18 months. Therefore, it may be better to protect certain IP as a “trade secret”, depending upon the nature of the IP. Indeed, if an operations manual or other publication is to contain “trade secrets”, franchisors are well advised to so state on the document itself and require their franchisees to take steps to guard it (and its employees), such as insisting that only certain of the franchisees’ employees have access to it, and that each franchisee maintains it in a secure place with limited access to others.

Franchisors often employ restrictive covenants within their franchise agreements to prevent a former franchisee (after termination of the franchise agreement) or any person who had access to confidential information or trade secrets from subsequently competing with the franchise (e.g., working for a competitor). However, restrictive covenants may not be enforceable or the extent of enforceability may be limited. Some states will find them void or unenforceable as a matter of law, and many will not enforce them unless they are truly necessary to protect IP or a brand, and the person(s) being restrained have been adequately compensated. Recently, federal and state regulators have been “cracking down” on over-reaching franchisor’s post-employment restrictive covenants as violating anti-competition laws or restraints of trade. Therefore, franchisors should not just rely upon restrictive covenants to protect their IP.

Finally, the reputation associated with a brand must be protected from (increasingly all-too-common) online assaults. In this current climate, online social media, third-party product or service reviews, or other online commentary or postings, can have a significant and wide-reaching negative impact on a trademark or brand. As a result, franchisors must now not only remain vigilant in protecting their trademark or intellectual property from being stolen or usurped, but also from unfairly disparaging commentary or defamatory material. Franchisors (and franchisees) are not helpless against unlawful reputational assaults on their branding or trademarks. Traditional common law defamation, based upon the relevant state law, may be utilised when false claims are made concerning a brand or service. In addition, the Lanham Act may also be utilised to protect a federal trademark from statements that might be misleading to consumers, even if such statements are not literally false (which may open the door to bringing claims under the Lanham Act to protect a mark from statements that might not be literally false, but which may be misleading).

The FTC Act may allow a franchisor to seek assistance from the FTC due to a third party utilising “unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce...”. 15 U.S.C. §45(a)(1). Little FTC Acts in particular states may also apply, including what are often called unfair and deceptive trade practices acts, and allow a franchisor to bring an action based upon these state

statutes to protect its branding from unfair online competition or commentary. Finally, most online service providers have terms of service that prohibit defamatory or unfairly disparaging speech. Often, it may be sufficient (and cost effective) to directly contact a service provider and attempt to have the offending material removed under the terms of service, at least in the first instance, rather than resort to litigation. However, prior to bringing any action, a franchisor should be mindful that the U.S. has particularly strong public policy rights associated with freedom of speech. The franchisor should consider whether the potentially offending content is protected opinion, or otherwise qualifies for protection as free speech. There are implications (such as “Anti-SLAPP” statutes) that may punish overly litigious franchisors who bring lawsuits that improperly infringe upon someone’s right to the freedom of speech. If a franchisor wishes to engage in litigation to address potentially defamatory misconduct, it is highly recommended that knowledgeable counsel be retained, as ill-advised litigation can backfire.

4.3 Is copyright (in the Operations Manual or in proprietary software developed by the franchisor and licensed to the franchisee under the franchise agreement) protected by local law?

The U.S. is a signatory to many treaties and conventions concerning copyrights, including those overseen by the WIPO. Within the U.S., federal law protects both registered and unregistered copyrighted material. The Federal Digital Millennium Copyright Act (“DMCA”) also provides a mechanism whereby copyright holders can directly notify third-party online service providers that an infringement is occurring (e.g., through a user posting a confidential portion of an operations manual) and ask that the provider remove or disable any access to the infringing material. Most third-party internet service providers also have terms of service that prohibit infringement, and will remove offending material on that basis alone, once notified of unauthorised use of copyrighted material. In addition, common law rights (or even statutory rights conferred by states), such as claims for misappropriation or unfair competition, may overlap with copyright law to protect information within publications. Nonetheless, there are exceptions to copyright (such as “Fair Usage”), and a franchisor should carefully consider the pitfalls that it may encounter before it commences a lawsuit seeking to protect its copyright.

Franchisors should be mindful that a wide variety of publications and media, including operations manuals, websites and online content, social media pages and content, advertisements, menus, or computer programs may be protectable by copyright. Franchisors should be careful to draft clear agreements covering employees, agents or vendors that designate “work for hire” copyright ownership to the franchisor for materials that are created for the franchisor (lest, for example, a franchisor inadvertently grants “ownership” of an expensive, custom-designed computer program to a computer programmer).

The culture of the U.S. tilts decidedly towards protecting intellectual property rights, and punishing those who would misappropriate or engage in unauthorised usage or plagiarism of another’s intellectual property. Federal law often provides for the assessment of additional damages, including exemplary (sometimes treble) damages, and attorney fees, against those who violate the law in this regard. However, a recent decision also cautions that copyrighted materials and generic ideas, including those in “confidential” proprietary franchise operation manuals, even if copied verbatim, may not necessarily qualify for protection. See, e.g., *Civility Experts Worldwide v. Molly Manners, LLC*, 15-cv-0521-WJM-MJW, 2016 WL 865689 (D. Colo. 2016) (even

though sections of the franchise operating manual were copied practically verbatim, those portions were considered to be so basic, common, and generic, that they did not qualify for protection). There is a certain practicality that courts will generally apply; even if a copyrighted work is protected, a franchisor must be prepared to explain how its unauthorised use truly harms a franchisee.

The upshot is that it is not prudent for a franchisor to rely upon statutory protection alone to protect its IP. A franchisor should have clear and enforceable provisions within its franchise agreements protecting the IP and declaring it a material breach for any failure to do so (in addition to any regulatory or statutory protections). These provisions should make it clear that any IP or manuals are the property of the franchisor and are only being temporarily licensed. The dispute resolution provisions should provide a “carve out” for a franchisor to go to court to obtain injunctive or other relief to protect its IP, and upon termination of a franchise, a franchisor should require destruction or return of any and all property and IP that a franchisor wishes to protect, so at the minimum, breach of contract may be employed in addition to statutory or other rights. Franchisors must diligently police any information that they want to protect as confidential or as trade secrets, regardless of what is set forth in its contracts, or what statutory remedies may or may not apply. Here, being lax is not an option, and a well-timed “cease and desist” letter may not only serve to avoid litigation, but also evince to a court that a franchisor is taking its rights seriously, and diligently acting to protect its intellectual property.

5 Liability

5.1 What remedies can be enforced against a franchisor for failing to comply with mandatory disclosure obligations? Is a franchisee entitled to rescind the franchise agreement and/or claim damages?

The FTC Franchise Rule does not provide a private right of action upon which a franchisee can sue its franchisor for disclosure violations. So, under federal law, the franchisee’s only recourse is to refer the matter to the FTC for enforcement. Until recently, such a referral was also unlikely to yield any results since the FTC has, historically speaking, rarely sued franchisors for violating the FTC Franchise Rule. In February 2022, as part of an apparently new, more aggressive approach to enforcement, the FTC filed an enforcement action against a certain franchisor for alleged pre-contract misrepresentations and launched a new fraud reporting tool. It remains to be seen whether the FTC will maintain this more aggressive approach to enforcement in the future.

A franchisee can sue its franchisor (and the franchisor’s control persons) under any applicable state statutes that afford protection to franchisees, including, *inter alia*, under a state’s unfair trade practices act (“Little FTC Act”), franchise statute, and/or business opportunity law. Then, if the franchisee prevails, the franchisee may be entitled to rescission and/or damages, as well as costs, reasonable attorneys’ fees and statutory interest. Rescission, which is designed to restore the parties to the “*status quo ante*” (the condition they were in before the violations occurred), provides for the restitution of any money previously paid by the franchisee to the franchisor (e.g., the franchise fee and royalty payments). Depending on the state law, it may also entitle a franchisee to recover its initial investment costs and operational losses. However, rescission may only be available under limited circumstances (e.g., for wilful and material violations). In a few states, courts have discretion to award treble damages to plaintiff franchisees who prevail on their franchise claims. The rights and potential remedies available to a

franchisee will vary by state and so it is generally advisable for a franchisee to retain counsel knowledgeable in the applicable state’s franchise law. State enforcement agencies may also seek to impose civil and criminal penalties or obtain an injunction against a non-compliant franchisor.

Regardless of what statutory framework may (or may not) be available to a franchisee that wishes to sue its franchisor, a franchisee can still try to sue its franchisor under the common law (e.g., for negligent or fraudulent misrepresentation, or fraudulent inducement). But, in most cases, the common law claims will not be as strong as they might otherwise be if they were statutorily driven, and the remedies available are likely to be more limited.

5.2 In the case of sub-franchising, how is liability for disclosure non-compliance or for pre-contractual misrepresentation allocated between franchisor and master franchisee? If the franchisor takes an indemnity from the master franchisee in the Master Franchise Agreement, are there any limitations on such an indemnity being enforceable against the master franchisee?

To be a “Master Franchisee”, the Master Franchisee must both: (a) enter into unit or sub-franchise agreements with franchisees; and (b) provide ongoing business support to the franchisees after signing. Such a Master Franchisee is regarded as a Sub-Franchisor and must comply with its disclosure obligations under the FTC’s Franchise Rule and any applicable state disclosure laws.

The FTC’s Franchise Rule and most state franchise statutes consider the Master Franchisee and franchisor to be jointly and severally liable for their violation(s) of the disclosure laws. It is typical, therefore, for a franchisor and Master Franchisee to include a mutual indemnification provision in the Master Franchise Agreement. Such indemnity provisions are generally enforceable, except, in certain states, where an indemnification provision covering the intentional misconduct of the indemnitee is void as a matter of public policy.

5.3 Can a franchisor successfully avoid liability for pre-contractual misrepresentation by including a disclaimer in the franchise agreement?

Under the FTC’s Franchise Rule, it is an unfair or deceptive trade practice for a franchisor to disclaim, or require a prospective franchisee to waive reliance on, representations made in the FDD itself. Accordingly, disclaimers are ineffective with respect to representations made in the FDD. Additionally, disclaimers cannot protect a franchisor from liability for a material omission in its pre-contract disclosures.

Disclaimers can only protect a franchisor from liability for pre-contract misrepresentations that are extraneous to the FDD. As a rule of thumb, specific disclaimers are more effective than general, boilerplate disclaimers or integration clauses. For this reason, franchisors often require that franchisees sign, along with the franchise agreement, a detailed questionnaire affirming what representations were or were not made prior to the sale.

Several state franchise laws have anti-waiver provisions that void any contract term that purports to waive a franchisee’s legal right to sue under the franchise statute, including, *inter alia*, for a franchisor’s pre-contractual misrepresentations. In other jurisdictions, merger and integration clauses may not be able to defeat a claim for fraudulent inducement based on the theory that fraud is extraneous to the contract.

Disclaimers do not provide a franchisor with the perfect panacea to all of the headaches caused by the pre-contract

misrepresentations the franchisor may have improperly made; however, if nothing else, the franchisor can try to defeat a franchisee's pre-contract misrepresentation claims by pointing to the disclaimer clauses as evidence that the franchisee did not reasonably rely on the misrepresentation.

5.4 Does local law permit class actions to be brought by a number of aggrieved franchisees and, if so, are class action waiver clauses enforceable?

Yes, franchisees can join together to file a multi-plaintiff lawsuit or even a class action lawsuit if the putative class meets the applicable federal or state law requirements for class certification. If a franchisee association can show that it has standing to sue, it may be able to sue the franchisor on behalf of its franchisee members. Alternatively, a franchisee association can set up a litigation fund to sponsor a lawsuit by one of its franchisee members.

However, franchisees are almost always limited to suing the franchisor on an individual basis, since their franchise agreements invariably require them to relinquish any right to participate in a group or class action lawsuit. Typically, class action waiver clauses are included in the arbitration provisions of a franchise agreement and prohibit class or group arbitrations. It is settled (U.S. Supreme Court) law that class action waivers contained within arbitration provisions are enforceable. Standalone class action waiver provisions are also generally enforceable but may not be enforced under certain state laws if they are found to be unconscionable.

6 Governing Law

6.1 Is there a requirement for franchise documents to be governed by local law? If not, is there any generally accepted norm relating to choice of governing law, if it is not local law?

The franchisor usually insists that the choice of law provision in its franchise agreement applies the law of its home state to the contract and to any related disputes. To avoid inadvertently burdening itself with the requirements of a home state franchise statute that does not otherwise apply to out-of-state franchisee, the franchisor will typically also include additional language specifying that the state's franchise law does not apply unless its jurisdictional requirements are independently met. For practical reasons, it is uncommon for a franchise agreement to be governed by a foreign franchisor's local laws.

Choice-of-law provisions are generally enforceable as long as: (1) there is a substantial nexus between the selected state and the parties or the transaction, or some other reasonable basis for the parties' choice; and (2) the selection does not violate the public policy of the state with the predominant interest. However, choice of law provisions will likely be ineffective in cancelling out a state franchise law that is otherwise applicable. Some state franchise laws have an anti-waiver provision. Other state laws specifically mandate that the local state's franchise law protect franchisees within the state and override any choice of law provision.

6.2 Do the local courts provide a remedy, or will they enforce orders granted by other countries' courts, for interlocutory relief (injunction) against a franchisee to prevent damage to the brand or misuse of business-critical confidential information?

A franchisor has the right under U.S. federal and state law to seek an injunction against a franchisee that has gone "rogue".

For example, a franchisor can sue for an injunction under the Lanham (Trademark) Act and/or the DTSA to protect its trademarks, trade secrets and confidential business information (e.g., operations manual). To obtain such an injunction, the franchisor will usually seek recourse by filing a court action. Even a franchise agreement that requires arbitration of disputes relating to or arising under the contract will typically "carve out" the right to seek injunctive relief in court. Under the rules of certain arbitration organisations (e.g., the American Arbitration Association ("AAA") and JAMS), arbitrators have the authority to grant interim relief – including injunctive relief – and other emergency relief if such relief is sought in an arbitration proceeding.

The U.S. is not a signatory to any treaty or convention that requires its courts to recognise or enforce judgments issued by any foreign courts. Still, U.S. courts typically recognise and enforce final and valid foreign judgments in accordance with recognised principles of international comity. The general trend, in respect of recognition and enforcement of foreign judgments granting injunctive relief, shows that while some U.S. courts have enforced foreign court orders for permanent injunctive relief, they have been less willing to enforce preliminary injunctions issued abroad (since they are not final and conclusive judgments).

6.3 Is arbitration recognised as a viable means of dispute resolution and is your country a signatory to the New York Arbitration Convention on the Recognition and Enforcement of Foreign Arbitral Awards? Do businesses that accept arbitration as a form of dispute resolution procedure generally favour any particular set of arbitral rules?

Arbitration is clearly a viable means of dispute resolution under U.S. law. As codified in the Federal Arbitration Act ("FAA"), the U.S. even considers arbitration to be a favoured means of dispute resolution. The FAA pre-empts any U.S. state law that attempts to deny or even just limit the right of contracting parties to arbitrate disputes involving interstate commerce. The International Centre for Dispute Resolution ("ICDR") (the AAA's international division) and the International Institute for Conflict Prevention & Resolution ("CPR") are two of the most well-established international arbitration forums located in the U.S. Additionally, the International Chamber of Commerce ("ICC") can administer arbitrations from its New York City office. Other organisations such as the London Court of International Arbitration ("LCIA") can conduct U.S.-seated arbitrations from their foreign offices. *Ad hoc* (self-administered) arbitrations often proceed in accordance with the UNCITRAL Arbitration Rules or the CPR's Non-Administered Arbitration Rules. As a result of the COVID-19 pandemic, many international arbitration organisations have either updated their rules or issued protocols for hearings to take place remotely.

The U.S. adopted the New York Convention in 1970, agreeing to recognise and enforce commercial arbitration awards made in the territories of other contracting states. It also later ratified the Inter-American Convention on International Commercial Arbitration (Panama Convention), which requires that the U.S. and most South American nations enforce arbitration agreements and awards in one another's countries. The New York Convention and Panama Convention have been codified as U.S. law in Chapters 2 and 3, respectively, of the FAA. The certainty that an arbitral award will be recognised and enforced by the courts of the contracting states is a major reason why arbitration is such an attractive method of resolving international business disputes.

7 Real Estate

7.1 Generally speaking, is there a typical length of term for a commercial property lease?

The U.S. represents a huge real estate market with urban, suburban and rural areas. It is not one homogenous market, but rather comprises diverse areas within which there are wide differences with respect to commercial leasing conditions. As such, there is no typical length of term for a commercial lease in the U.S. The term may vary depending on a variety of factors including, for example, the area type and specifics of the local market, the premises (e.g., retail, office or industrial), general economic and market conditions, the landlord, lender requirements, franchisor requirements, etc. In major metropolitan areas and in shopping centres, it is common to have leases for retail spaces that are for 10 years or more. While, perhaps, this may not be as prevalent in smaller communities, even there, leases of 10 years (or more) can usually be negotiated for well-known franchise brands. (While there is no standard length of franchise agreement in the U.S., many franchise agreements have an initial term of 10 years.) Tenants often seek to incorporate one or more option terms into their leases. Some franchisors, and some franchisees (if they are represented by knowledgeable counsel) will prefer to have the term of the franchise agreement (with any renewals) coincide with or be “coterminal” with the term of the lease being entered into (including any options). Generally, there are no statutory rights regarding a commercial tenant’s or franchisee’s right to “hold over” at the end of the lease’s contractual term. In most instances, commercial leases contain provisions requiring the tenant to pay anywhere between 125% and 200% of the Base Rent and Additional Rent during any holdover period(s), although the amount of the overage, as is the case with most lease provisions, is usually subject to negotiation.

7.2 Is the concept of an option/conditional lease assignment over the lease (under which a franchisor has the right to step into the franchisee/tenant’s shoes under the lease, or direct that a third party (often a replacement franchisee) may do so upon the failure of the original tenant or the termination of the franchise agreement) understood and enforceable?

Yes, this concept is understood and is often addressed by contractual agreement, both in the franchise agreement and, if properly negotiated, in the lease as well. Sophisticated landlords are generally aware that franchisors often reserve rights in their franchise agreements that will enable the franchisor, an affiliated entity or another approved franchisee, to “step-into” the franchisee/tenant’s shoes, either to temporarily operate the franchisee’s business (see commentary at question 16.2 below), or to take an assignment of the lease if either of two events occur: (i) the franchisee’s lease is terminated by the landlord; or (ii) franchisee’s franchise agreement is terminated by the franchisor. Some landlords will consent to such a requested lease term by so providing in a three-party rider or addendum to the lease, which is executed by the franchisor, franchisee/tenant and the landlord. Landlords will usually require that the franchisor (or other assignee) must cure any defaults (including the payment of any outstanding rent/additional rent, etc.) before the franchisor or another franchisee can take over the lease. Savvy franchisors or franchisees may negotiate a lease term providing that, under such circumstances, the landlord’s consent will be “deemed” to have been given and that the only requirement is that proper notice be provided to the landlord. Other landlords

may resist agreeing to such a provision outright, while others may seek to obtain financial concessions from the franchisor in return for agreeing to such a provision. For example, where landlords have required the franchisor or franchisee to provide either a full or partial guaranty of the lease (e.g., a “good guy” guaranty where the guarantor is responsible for all of the obligations under the lease for only such period of time that the tenant remains in possession of the premises), the landlord may require that a comparable guarantor be added (or substituted) as part of the transaction. Whether or not the franchisee/tenant, as well as any guarantor(s), will be released from liability under the lease upon such a sale is also a key issue to be negotiated.

7.3 Are there any restrictions on non-national entities holding any interest in real estate, or being able to sub-lease property?

Typically, not in the franchise context. While U.S. federal law restricts foreign ownership of certain federal oil, gas and mineral leases, and authorises the blocking of certain foreign acquisitions of U.S. companies with respect to particular industries that potentially impact national security, energy resources and critical infrastructure, such restrictions are generally inapplicable to franchising opportunities in the U.S. Under federal law, foreign owners or investors in U.S. real estate are subject to U.S. tax to the same extent as domestic owners are. In most instances, foreign investors would acquire U.S. real estate interests, including leases, by utilising single purpose U.S. entities that are created specifically in order to acquire or lease the real property.

7.4 Give a general overview of the commercial real estate market. To what extent has the real estate market been affected by the Coronavirus pandemic? Specifically, can a tenant expect to secure an initial rent free period when entering into a new lease (and if so, for how long, generally), or are landlords demanding “key money” (a premium for a lease in a flagship location)?

The U.S. commercial real estate market is large and varied. Prior to the emergence of the COVID-19 pandemic, the commercial real estate market was in the process of recovering from the “great recession” of 2008 through 2012. In certain metropolitan areas, the real estate market had recovered fairly well and it was not uncommon for landlords to charge premium rents for “Class A” and other desirable retail locations. Prior to the pandemic, certain events had been negatively impacting the retail section of the U.S. commercial real estate market, including, in significant part, the impact that the purchase of products on the internet has had on retail sales generally, and inevitably, on the sale of products from franchised (or franchisor-owned) retail locations. According to a study by Aaron Smith and Monica Anderson, by 2015, approximately 10% of annual retail purchases, almost \$350 billion, were purchased online. Further, almost 80% of Americans make purchases via the internet. This trend will likely continue and is likely to have an increasingly negative impact on “brick and mortar” retail purchases generally, and on franchised retail outlets, specifically. Until the last recession (e.g., 2008–2012), malls and shopping centres in the U.S. had experienced explosive growth since the 1950s. However, based on the internet’s continuing negative impact on retail locations (including franchised outlets), malls and shopping centres may well become smaller and rents may have to be reduced in order to induce retailers to make long-term commitments that both landlords and lenders desire or require. It is unlikely that we will see, in the foreseeable future,

the kind of explosive growth that malls and shopping centres had previously experienced. We are starting to see retail space undergoing a major transformation, where the trend, generally speaking, has been that “low-quality” retail premises have been struggling and “high-quality” retail premises are more likely to be successful (especially where consumers enjoy services and entertainment as opposed to buying durable goods that can easily be purchased “online”). This recent trend has helped to keep retail rents at more reasonable levels.

Partly as a result of these factors, reasonable construction periods (which vary depending on the location and type of work to be done), landlord contributions to tenant “work letters” and some “free rent” periods, continue to be frequently available in metropolitan areas. In other areas of the country, including more suburban and rural areas, where the real estate market (and the local economies generally) have been, perhaps, more “hard hit”, it is even more common for tenants to obtain a period of free rent and/or tenant improvement allowances.

The specific work that the landlord agrees to do in order to prepare the premises for the franchisee/tenant’s occupancy is memorialised in a “work letter”, which is almost always subject to negotiation. It will be influenced by such factors as the length of the lease term, the tenant’s credit worthiness and overall “desirability” and, of course, the rent to be paid. The time needed to perform both landlord’s and tenant’s work will vary according to the nature of the work to be performed but will typically range from 60 days to six months and, sometimes, may be even longer where it is anticipated that particular zoning or “permitting” issues will apply. While no rent will be charged during the construction period, tenants frequently seek out an additional “free rent” period after the premises opens for business while still within the construction period and, in some cases, even after the construction period has ended. In certain areas, such as where a free-standing building is being constructed for the franchised unit, or for larger construction projects, such as hotels, even longer construction periods, and “free rent” periods, may come into play.

In certain metropolitan areas where the real estate market had recovered well, landlords would sometimes charge commercial tenants so-called “key money” as a premium for the tenant’s right to secure the lease. The pressure from internet sales has had a negative impact on this practice. In most cases, where key money is a factor, the deals usually involve transactions where an existing lease and infrastructure (e.g., built-in furniture, specialty plumbing or electrical work) are transferred to a new tenant and the landlord requests a one-time payment in recognition of the extra facilities and the convenience that the tenant is inheriting. Examples of this situation may include a restaurant having a recently upgraded infrastructure in place, or where a petrol station having substantial equipment improvements is being transferred to a new tenant (petrol distributor). Unlike the residential context where tenants are sometimes asked to pay “key money” to superintendents or building managers in order to secure a flat (such “off the books” practices are illegal), in the commercial real estate market context, requests may be presented so long as the money is requested by the landlord and is paid by the tenant and set forth in the lease.

Impact of the COVID-19 pandemic

Beginning in the spring of 2020, millions of American employees were unable to travel to their workplaces because state and local government authorities issued “stay at home” orders and ordered all “non-essential businesses” to “shut down”. As a result of the pandemic, many retail locations and other businesses (including franchises) defaulted on their leases in 2020 and 2021 and attempted to negotiate with their landlords as to the waiving or deferring of rent and additional rent, and to avoid being evicted from their premises (when existing eviction moratoriums were

eventually lifted). Further, as many larger businesses have been reluctant to require their employees to return to their offices, especially in urban areas, the commercial office market in metropolitan areas has continued to struggle, and this has caused some “brick and mortar” franchises to suffer, which rely on foot traffic by customers. With the COVID-19 pandemic not yet under control and with health experts predicting that that it will continue for the foreseeable future, at least to a certain extent, we believe that there will be a significant softening of the commercial real estate market in the U.S. through at least the end of 2022, especially with respect to “Class A” retail and office space, both in urban and suburban areas. This is also true as a general slowing of the economy (and a possible recession) is predicted for the remainder of 2022 and continuing into 2023, based upon record-high inflationary pressures currently being experienced throughout the U.S. and supply-chain disruptions that continue to be experienced.

8 Online Trading

8.1 If an online order for products or request for services is received from a potential customer located outside the franchisee’s exclusive territory, can the franchise agreement impose a binding requirement for the request to be re-directed to the franchisee for the territory from which the sales request originated?

Yes. The franchise agreement can regulate how online orders are allocated. However, with the increase in importance of online commerce, a franchisor should take great care to adequately define in the franchise agreement, and similarly, to disclose in the FDD (along with required state disclosure documents), how such online orders will be handled. Clarity is critical, and franchisors should remember that an FA and FDD are, in reality, protective documents, designed to put a prospective franchisee on notice of what is, and what is not, part of the market or territory they are purchasing the rights for, whether it be in the tangible physical world, or the realm of digital commerce. Unless a territory is truly “exclusive”, franchisors should avoid words like “exclusive” territory in order to avoid confusion, and make sure that prospective franchisees are put on notice as to the manner in which online orders are handled within a franchisee’s territory. (Item 12 of the FTC Rule requires that if a franchisor does not grant “exclusive” territories to its franchisees, the franchisor’s FDD must include a disclaimer underscoring that fact.) Conversely, franchisees must be made aware of whether or not a franchisor is granting them rights to engage in online commerce, and what limitations are placed upon those rights. Franchises that do not contain the right to engage in online commerce, or that must compete with the franchisor, or other franchisees, even if a sale occurs within the geographic territory being franchised, may not be as valuable, as online commerce gains traction compared to more traditional “brick and mortar” transactions, or those limited to geographic territories. (The FTC Rule requires that the FDD include separate detailed disclosures regarding whether a franchisor reserves the right to sell its products through “alternative channels of distribution” in the franchisee’s territory, including e-commerce.)

As e-commerce continues to mature, prospective franchisees who are purchasing a franchise should carefully review the territorial protections and online market provisions described in the FDD and provided for in the franchise agreement with great care. Access to the online market can significantly impact the profitability of a franchise, and both franchisor and franchisee should be clear about their respective rights.

From an antitrust perspective (see section 3 above), there is no specific statutory restriction upon a franchisor's limiting access by its franchisees to the online market (as might be the case in other countries). However, a franchisor's failure to clearly define a franchisee's rights with respect to online sales, especially in its required disclosure documents and franchise agreements, may result in litigation, including claims by aggrieved franchisees that a franchisor has committed "disclosure" violations (including violations of both federal and applicable state law), and common law claims for fraudulent or negligent omission, breach of contract, and/or breach of the implied covenant of good faith and fair dealing. Further, franchisors should be cautious about employing new methods of online purchasing, or implementing requirements that online business be conducted through a national website, where existing franchise agreements may not have fully contemplated or delineated the rights of the parties with respect to online sales. Where online sales divert enough business away from a franchisee's exclusive territory, or the franchisor has not specifically reserved its rights to compete with franchisees online, such changes could violate implied covenants of good faith and fair dealing, or potentially even state-specific franchise laws (see, e.g., Wis. Stat. §1365.03 (franchisor may not substantially change the competitive circumstances of a dealership without good cause); IN Code §23-2-2.7-1(2) (prohibitions against franchisor competing unfairly with franchisee, or within franchisee's designated protected territory); NJ Stat. §56:10-71 (franchisor may not impose unreasonable standards of performance)). Franchisors and franchisees alike should take care to properly delineate and understand how online commerce impacts a franchisee's territory, as well as customer availability, and properly reflect it within their agreements.

In addition, and in large part as a result of the COVID-19 pandemic (which, unfortunately, may not be over as of the drafting of this piece), many franchisors and franchisees have had to adapt their basic methods of conducting business to include new or enhanced online sales so they can continue functioning. Governmental orders and mandates have in many instances limited the ability of businesses to conduct "in person" commerce, or have otherwise significantly altered customer interactions. Further, with successive waves of new variants of COVID-19, there is the possibility that governmental restrictions, even if lifted at present, may return. Franchised businesses have therefore increasingly relied upon engaging in online transactions, and even embraced the stability of online commerce, whether it be entirely online, or to facilitate "contact-less" goods or services, such as ordering online for "drive-by" pickup, or delivery. This has become the new economic reality, even for franchised models that had previously relied upon traditional "brick and mortar" locations. Franchise systems must continue to be flexible, and franchisors and franchisees should work together in this new increasingly digital landscape, which will likely include significant re-working of online sales platforms and associated arrangements between franchisors and franchisees concerning online rights and restrictions affecting online sales. Systems that do not adapt and work together may suffer the loss of many of their franchised units. It is often no longer realistic or prudent for a franchisor to reserve digital commerce entirely to itself, as customers now expect online services and sales, whilst franchisees need to be part of a system's online business in order to survive. Further, the failure of a franchisor to fairly and adequately address their franchisees' needs in this new marketplace, may subject themselves to claims by franchisees for refusing to reasonably accommodate them in these new circumstances, including for breach of the implied covenant, impossibility, and frustration of purpose, despite what the FDD or franchise agreement may say. Like it or not, the

prevalence and necessity of digital commerce has been advanced significantly due to COVID-19, and most franchised systems need to address how they will adapt to this increased usage of e-commerce, lest they be left behind as consumers become more reliant on e-commerce in the future, or ultimately even be put out of business.

8.2 Are there any limitations on a franchisor being able to require a former franchisee to assign local domain names to the franchisor on the termination or expiry of the franchise agreement?

No. A franchisor may require (in its franchise agreement) that a franchisee utilise a specific domain name, and return usage of that domain to the franchisor after expiration of the franchise. It is advisable that a franchisor disclose domain name requirements within the FDD, and that the franchise agreement clearly set forth any post-termination requirements with respect to domain names. The ICANN regulates the usage of domain names, and franchisors may seek transfer of a domain name under ICANN's UDRP proceedings to effectuate the transfer of a domain name. Where a franchisee's domain utilises a franchisor's protected trademark within the domain name, the UDRP is far more likely to require transfer back to the franchisor, even if a dispute arises (and the usage of a protected trademark in the domain name may give a franchisor additional Lanham Act claims). If the infringement involves a generic top-level domain ("gTLD") and in clear-cut trademark infringement matters, ICANN's newly adopted URS domain name suspension procedure can be used to suspend infringing domain usage (but suspension of the infringing domain is the only remedy in a URS matter).

Given the above, franchisors should craft domain-specific provisions in their FDDs and franchise agreements with care and take steps to ensure they maintain control over their domain names. Franchisors may consider having franchisees agree in writing to transfer their domain rights to a specific domain at the time of termination of the franchise, or alternatively, control the rights to a specific domain themselves, and grant the franchisee a licence to utilise the sub-domain during the franchise relationship. Notably, if a franchisor does not take steps to timely effectuate the transfer of a domain name, or object to a former franchisee's continued use of a domain in violation of an agreement, it opens itself up to laches, acquiescence and waiver arguments (see, e.g., *American Express Marketing and Development Corp v. Planet Amex et ano.*, NAF UDRP Proceeding, Claim No. FA1106001395159 (Jan. 6, 2012) (the domain would properly stay with the franchisee, as the franchisor "acquiesced to the use of its mark in the Respondent's domain name for at least a period of several years")). Franchisees should similarly be aware that if a domain name is the property of a franchisor, any systems reliant upon that domain name, including any e-mail accounts, internal data and communications, associated online media content and contacts, and any other identifiers tied to that domain name may be abruptly discontinued at the end of a franchise agreement's term. A termination could therefore result in significant business disruption, including the loss of client contacts, and potentially years of e-mails and other domain-dependent communications and information. In the realm of digital commerce, it is crucial where a search engine (such as Google) lists a particular domain. The value of a long-standing and high-listed domain, with carefully cultivated links and online presence, can be substantial. It can take years, and substantial effort and cost, to re-build a business' online presence in the event a high-ranking domain is lost. Counsel should examine relevant

provisions in an FDD or franchise agreement carefully, so clients are fully aware of the implications of termination of the franchise upon domain-name usage, and potentially the ability of a business to continue functioning after de-identification. This may also have unintended consequences in the event of litigation, as the abrupt cessation of communications may lead to additional claims. Further, transfer of a domain without consideration for the preservation of data (or electronically stored information that may be relevant evidence in a litigation), particularly with cloud-based storage and services, and the consequences of who has (or takes) possession of that data, or who even has access to that data, can be significant if litigation ensues. As a cautionary note, franchisors who terminate a franchisee, and take possession of a domain used by the terminated franchisee (along with any “Electronically Stored Information” (“ESI”) attendant thereto), but that do not take steps to preserve electronic evidence (such as ESI, including e-mails, that may reside on a domain that they control), may find themselves the target of motions for discovery preservation sanctions. Franchisors should be careful to preserve evidence if litigation is reasonably anticipated. Franchisees should be aware that if they are terminated, they may not have access to ESI that is critical to day-to-day functionality, which now may be in the exclusive possession custody or control of a franchisor. Therefore, given the ever-increasing importance of this issue with the expansion of e-commerce, it is imperative that at the outset of a franchise relationship, both franchisee and franchisor should be aware of what the relevant FA states with regard to ESI and domain names, and be guided accordingly.

9 Termination

9.1 Are there any mandatory local laws that might override the termination rights one might typically expect to see in a franchise agreement?

Yes. While federal law in the U.S., e.g., the Amended Federal Trade Commission Franchise Rule, governs the requirements with respect to how franchisors must provide proper disclosure to prospective franchisees, federal law does not govern any aspect of the franchisor-franchisee relationship after the parties enter into a franchise agreement. However, almost half of all states in the U.S. (and U.S. territories of Puerto Rico and the U.S. Virgin Islands) have so-called “relationship laws”, which govern one or more substantive aspects of the franchisor-franchisee relationship. Common examples include: restrictions on termination, non-renewal, and/or transfer; limitations on the franchisor’s ability to open a new company-owned or -franchised unit in the vicinity of the franchisee’s location (“encroachment”); limits on post-term non-competition agreements; permitting “free association” among franchisees; requiring that a franchisor act in good faith or with reasonableness when dealing with its franchisees; and the inclusion of “non-waiver” provisions with respect to the state statute’s protections. Beginning in the 1970s, these relationship statutes were enacted by state legislatures in an attempt to correct some of the significant perceived abuses that franchisors were committing against prospective and current franchisees. State relationship laws vary considerably, both in terms of the breadth of the issues that are addressed, and with respect to the specific provisions and restrictions that are contained within them. Some relationship laws are made part of the state’s franchise registration or disclosure statute, while others are set forth in a statute that is separate from the state’s disclosure/registration laws. Some states, however, have relationship laws but have enacted no franchise disclosure/registration law.

State relationship laws typically address (e.g., restrict) the franchisor’s ability to terminate or fail to renew the franchise. Most

of them require a franchisor to have “good cause” (or “reasonable cause”) before it is permitted to either terminate or not renew a franchisee’s franchise. (Where applicable, such laws will override and make unenforceable, inconsistent provisions contained in the franchise agreement. For example, a provision stating that the agreement will expire at the end of a particular term if the franchisee has no right to renew may be unenforceable.) While some relationship laws define “good cause” (or “reasonable cause”), others do not, leaving this determination to the courts. However, good cause generally exists if the franchisee has breached a material obligation of the franchise agreement. Typically, under relationship laws, the franchisor is required to provide the franchisee with written notice (for example, between 30 and 90 days, which is often significantly longer in duration than what is provided for in the franchise agreement), within which the franchisee may cure the alleged default and avoid termination. However, in instances where the default involves the franchisee’s failure to pay monies owed to the franchisor, the permitted notice/cure period under relationship laws is often considerably shorter. Additionally, for certain defaults that are perceived to be egregious and/or that pose a threat to the wellbeing of the public, or that are damaging to the franchisor’s brand, including, for example, posing a threat to the public’s health and safety (often, for example, in a food-related franchise), and/or are otherwise “uncurable” (for example, unauthorised use of the franchisor’s registered trademarks), or where certain exigent circumstances are present (for example, the franchisee’s insolvency or bankruptcy or the franchisee’s loss of its right to occupy its premises), the franchisor is usually statutorily permitted to terminate the franchisee’s franchise agreement, either immediately, or with a much shorter notice/cure period than what might otherwise be required. As applicable relationship laws supersede whatever inconsistent provisions are contained in the franchise agreement, franchisors, and their counsel, need to be aware of any applicable relationship law when evaluating how to handle a franchisee’s default and/or potential termination.

Almost all franchise agreements provide that the franchisor may terminate the franchise if the franchisee becomes insolvent or files for bankruptcy. However, under the U.S. Bankruptcy Code, a contractual provision permitting the franchisor to terminate the franchise agreement in the event of the franchisee’s bankruptcy may not be enforceable (see 11 U.S.C. §365(e)(1)(A)). If a franchisee files for bankruptcy before its franchise agreement and/or its lease has expired or has been properly terminated, such agreement(s) become(s) part of the debtor-franchisee’s (“debtor”) “bankruptcy estate”. However, the franchise agreement and/or lease may be terminated relatively quickly if the debtor (franchisee) files either a Chapter 7 “liquidation” or a Chapter 11 “reorganisation” but “rejects” the agreement(s) (e.g., consents to their cancellation). In the event that a debtor in a Chapter 11 reorganisation wishes to “assume” its franchise agreement or lease (i.e., keep it/them “in place”), it is unlikely that the franchisor will be able to quickly terminate these agreements provided that the debtor/franchisee was not in default of these agreements at the time the bankruptcy petition was filed. It is likely that the bankruptcy court will approve the assumption of these agreements if the debtor/franchisee is able to otherwise perform their respective terms, the agreement(s) appear(s) to be in the best interests of the debtor’s bankruptcy estate and the assumption of the agreement(s) is supported by reasonable business judgment. However, if the debtor/franchisee was in default of its agreement(s) at the time that the bankruptcy petition was filed, it is more difficult for it to assume them. In this situation, the debtor will likely have to: (i) cure, or provide adequate assurance that the trustee will promptly cure such defaults; (ii) compensate, or provide adequate assurance

that it will promptly compensate another party for any actual pecuniary loss that the party may suffer as a result of such default; and (iii) provide adequate assurance with respect to the future performance of such agreement(s).

9.2 Are there local rules that impose a minimum notice period that must be given to bring a business relationship that has existed for a number of years to an end, which will apply irrespective of the length of the notice period set out in the franchise agreement?

Yes. As discussed above in question 9.1, almost half of all states in the U.S. (and U.S. territories of Puerto Rico and the U.S. Virgin Islands) have so-called “relationship laws”, which govern one or more substantive aspects of the franchisor-franchisee relationship, such as the franchisor’s ability to terminate or fail to renew the franchise. In addition to typically requiring the franchisor to have “good cause” (or “reasonable cause”) before it is permitted to either terminate or not renew a franchisee’s franchise, most relationship laws require the franchisor to provide the franchisee with written notice (within which the franchisee may cure the alleged default and avoid termination), which may be significantly longer in duration (e.g., between 30 and 90 days) than the “cure” period provided for in the franchise agreement. The reason for such provisions is to protect franchisees from having their livelihood (and often a large financial investment) taken away from them on short notice. Where applicable, such relationship laws will apply irrespective of the express notice provisions (and/or governing law and jurisdiction provisions) contained in the franchise agreement, and any such inconsistent provisions will be deemed unenforceable. While U.S. courts generally cannot “revive” or reinstate a franchise after the franchisor has terminated the franchise agreement, a franchisee who successfully asserts a claim that the franchisor violated an applicable relationship law and improperly terminated the franchisee’s franchise agreement, will be awarded appropriate damages, prejudgment and post-judgment interest as well as court (or arbitration) costs, including reasonable attorneys’ fees that were incurred by the franchisee in connection with the litigation or arbitration. Franchisors, and their counsel, need to be aware of any applicable relationship law when evaluating how to handle a franchisee’s default and/or potential termination.

10 Joint Employer Risk and Vicarious Liability

10.1 Is there a risk that a franchisor may be regarded as a joint employer with the franchisee in respect of the franchisee’s employees? If so, can anything be done to mitigate this risk?

The “joint employer” doctrine is a concept in employment law. It expands the definition of “employer” to include additional persons or entities that exert sufficient influence or control over the “terms and conditions” of employment (directly, or sometimes, even indirectly), so that they will be considered a “joint” employer by law. Notably, the joint employer doctrine only applies in connection with, and is therefore limited to, violations of employment law (for example, violations of the Fair Labor Standards Act, 29 U.S.C. 201 *et seq.*, or National Labor Relations Act, 29 U.S.C. §151 *et seq.*).

Applying the joint employer doctrine in the franchise context is troublesome, because the franchisor-franchisee relationship, by its very nature, requires a franchisee (and its employees) to adhere to the franchised system or business model, and to follow

certain designated procedures. The hallmark of liability under the joint employer doctrine is the exercise of sufficient control over employees so as to be considered an employer. A franchisor may discover that by too closely regulating what the franchisee’s employees do, in trying to keep the franchise system uniform, it will be considered liable for employment law violations as a “joint employer”. Trouble areas include (but are not limited to) setting “required” work hours, mandating and controlling employee time-tracking software, becoming involved in employees’ wage and salary levels, training “line” employees, becoming involved in hiring or firing, setting employment practices and policies, resisting the unionisation of employees, and having managers of franchisees’ employees trained directly by a franchisor on matters that relate to how that manager ultimately manages those employees.

Although various forms of joint employment liability have been around for decades (see, e.g., *Falk v. Brennan*, 414 U.S. 190 (1973)), this issue began causing ripples in the franchise industry when the National Labor Relations Board (“NLRB”) announced a new joint employer standard stemming from a 2015 NLRB matter called *Browning-Ferris Industries*, whereby a franchisor could be considered a joint employer – even if it only exercised “indirect” control over a franchisee’s employees, or even if it sufficiently reserved the “ability to exercise such control”. Such indirect control was particularly troubling in the franchise context, as a franchised system, almost definitionally, must exert some degree of control over the operations of its franchisees. Multiple federal agencies followed suit (including the U.S. Dept. of Labor (“DOL”), and the “EEOC”). The Trump administration signalled it would reverse this course, but did not do so until February 20, 2020, when the NLRB issued a new joint employer rule under the National Labor Relations Act (“NLRA”), which removed the prior “indirect” control language, and in relevant part states “the entity must possess and exercise such substantial direct and immediate control over one or more essential terms or conditions of their employment...”. However, the Biden administration then rescinded the prior 2020 DOL rule, reverting back to the 2015 standard. See DOL Notice for 29 CFR Part 791, RIN 1235-AA37 (July 29, 2021) (“This action finalises the Department’s proposal to rescind the final rule titled “Joint Employer Status Under the Fair Labor Standards Act”, which was published on January 16, 2020 and took effect on March 16, 2020. This rescission removes the regulations established by that rule.”) With the current administration now adopting the prior *Browning-Ferris* standard, franchisors would be wise to assume a more defensive stance, and assume “indirect” control over a franchisees’ terms and conditions of employment may subject a franchisor to liability in the employment context.

In addition, many state laws never made the shift away from the *Browning-Ferris* standard, or had state statutes with broader interpretations of “joint employer”. Indeed, the cases brought by multiple AG’s offices challenging the prior standard have been working their way through the courts. See, e.g., *State Of New York et al v. Scalia*, Index No. 1:20-cv-01689-GHW (finding the 2020 Trump administration standard was improper). Each state may have its own laws and standards, some of which may be more permissive with respect to claims against the franchisor. See, e.g., *Griffith v. Coney Food Corps*, 19-cv-1601, 2020 WL 4748452 (EDNY, Aug. 17, 2020) (federal Title VII discrimination claims were dismissed, but “joint employment” allegations were sufficient under the “liberal construction” the court was required to afford the local New York State Human Rights Law, and New York City Human Rights Law). Franchisors should consult with knowledgeable franchise counsel, and exercise caution where some control over a franchisees’ employees may

occur, particularly within the realms of wage and hour, labour relations, or other terms and conditions of their employment.

Globally, however, this is a problem with a solution, and franchisors should remember that the application of the joint employer doctrine is limited to issues within the employment context. The reality is that it only has the potential to impact those franchisors who directly – or indirectly (depending on the standard) – exert control over the terms and conditions of their franchisees’ employment relationships, or specifically became involved in opposition to unionisation or collective bargaining with respect to their franchisees’ employees. Franchisors that do not seek to impose any significant control over the employees of their franchisees, especially in the labour relations arena, or wage and hour concerns, and who distance themselves from management or *even the training of a franchisee’s managers* with respect to employment issues, will significantly reduce their risk of being considered joint employers, or subject to NLRB scrutiny or NLRA liability.

The concern about joint employer liability has led industry groups to lobby for “carve-outs” that would exempt franchise systems from the new regulations. Indeed, the IFA has begun advocating for legislative action to avoid subjecting franchised systems to increased liability (and costs associated with it). See, e.g., <https://www.franchise.org/advocacy/brand-standards/joint-employer>. Another front in the franchise employer liability battle has been occurring in CA. CA has enacted legislation (Assembly Bill 5, Labor Law), which utilises a more permissive “ABC test”, which makes it easier for a court to consider someone an employer than more traditional “independent contractor” tests. Franchisor lobbyists are also actively working to get legislatures to recognise the unique ramifications of enacting legislation designed to protect employees that may have an unintended impact upon the franchising industry. The law in this area remains in flux and, unfortunately, there are conflicting standards being utilised. What may be well-meaning statutory initiatives designed to protect employees are, in the eyes of many in the franchising community, inadvertently adversely impacting the entire franchise industry, and exposing franchisors to significant liability and court costs in defending joint employer allegations.

That being said, the dire predictions that an avalanche of litigation would ensue from joint employer issues have yet to really materialise. Perhaps this is due to the issue being confined to employment law. It may also be due to continually fluctuating legal standards, and unsettled law on the topic. Class actions are also difficult to have certified, and unless a franchisor has really engaged in system-wide malfeasance directly impacting the terms and conditions of its franchisee’s employees, it is often difficult for plaintiffs to connect the alleged misconduct to system-wide malfeasance committed (or even known to) a franchisor, and then to show that such misconduct should be afforded class-wide certification across multiple locations. It is also likely that the utilization of the joint employer doctrine in litigation has been blunted by prudent steps that franchisors have taken, in being proactive by properly distancing themselves from active involvement in their franchisees’ employment issues, and providing franchise agreements, and importantly, operations manuals and other franchise guidance, which would have the effect of avoiding joint employer liability. Nonetheless, franchisors remain well advised, wherever possible, to avoid exerting excessive control over the terms and conditions of employment of their franchisees’ employees, while balancing such needs against maintaining system standards. A good rule of thumb is for franchisors not only to continue to maintain system standards and employee practices that have to do with the end product or service (sometimes called “control of outcomes”), but also to make it their practice to distance themselves from

directly engaging in setting policies or procedures regarding how a franchisee’s employees are managed in order to produce the end product or service (sometimes called “control of means”). For example, a franchisor of a sandwich shop can dictate in its operations manual precisely how a franchisee’s employees must assemble and produce its sandwiches, but should not become directly involved in training, hiring, firing, or setting hours and pay rates for the low-level employees producing those sandwiches. Notably, this must also include POS systems, and mandated electronic software by a franchisor. Franchisors increasingly are utilising system-wide POS systems, accounting software, and centralised franchise intranet portals for franchisees. Franchisors should carefully consider whether such systems can exert too much control over franchisees, or even violate state and local law, and it is often prudent to not only allow franchisees access, but also to provide the option to utilise their own employee management, time tracking, payroll, and employment-related software systems. See, e.g., *People v. Domino’s Pizza, Inc.*, Index No. 450627/2016; 2020 N.Y. Misc. LEXIS 2349 (Sup. Ct. May 27, 2020) (Domino’s avoided regulatory action for, *inter alia*, wage violations, by showing that franchisee usage of its PULSE software system, which if used for time tracking and payroll miscalculated wages due under NY law, was not mandated, other franchisees often used their own software, and it was ultimately a franchisee’s burden to ensure compliance with all wage and hour laws). Reflecting such delineations in franchise agreements and operations manuals, and keeping away from direct involvement in a franchisee’s affairs with its employees, will do much to avoid joint employer pitfalls.

10.2 Is there a risk that a franchisor may be held to be vicariously liable for the acts or omissions of a franchisee’s employees in the performance of the franchisee’s franchised business? If so, can anything be done to mitigate this risk?

Franchisors have been found to be vicariously liable for the acts or omissions of their franchisees (or their franchisees’ employees). However, vicarious liability, as a general rule, will only attach where a franchisor exerts so much control over the franchisee’s performance of the process or activity that is being complained of, that courts will find that the franchisor should be held responsible. The classic example is where a franchisor specifically mandates that coffee be served at a scalding hot temperature, they might find themselves vicariously liable if a franchisee’s customer burns themselves. Almost every jurisdiction has found that general operations manuals or enforcement of a franchisor’s general franchise system will not, by themselves, lead to vicarious liability. In contrast, where a franchisor has mandated a particular practice or policy that is directly responsible for the harm, there is a significant risk that vicarious liability will attach.

Franchisors need to balance their needs to provide guidance to their franchisees, including the promulgation of detailed policies and procedures, against exerting so much control over the day-to-day operations of franchisees that they open themselves up to a risk of vicarious liability. Where detailed specific controls are not necessary to maintain quality control of the franchised system, they should be avoided. Franchisors can also seek to minimise potential damages by having an appropriate indemnity provision in their franchise agreement, as well as by requiring that franchisees maintain adequate insurance coverage, and naming the franchisor as an insured party, especially where necessary to protect against particular liability concerns. Franchisors should take care that their system standards and operations manuals do not conflict with any federal and local laws, and make clear that the burden of assessing and complying with all local laws rests upon

the franchisee, and where the two conflict, the law will override any system standards or requirements.

In the current COVID-19 pandemic, vicarious liability should be examined carefully, particularly with respect to pandemic-related governmental action, and the franchisor should make clear to its franchisees that federal and local laws will override any contractual mandates or system standards. Further, franchisors should re-examine all customer safety protocols, particularly in the food, entertainment, health and fitness, and hospitality sectors, and require at the absolute minimum that franchisees strictly adhere to federal and local health and safety guidelines.

Other areas of recent concern have been Americans with Disabilities Act (“ADA”) compliance, where a franchisor is often named in an ADA lawsuit (or class action), along with a local franchisee. Again, if a franchisor has appropriately distanced itself from over-involvement in the specific methods of compliance, many claims can be avoided or summarily dismissed. Franchisors should avoid such over-involvement in construction or “build-out” of a location, particularly where it concerns compliance with ADA access. Similarly, franchisors should avoid the training of managers or employees (particularly with respect to how accommodations are to be given to disabled persons), and also reflect in Ops. Manuals and FAs that compliance with all disability laws is the franchisee’s burden. Guidance certainly can be given in Ops. Manuals, but it should always be tempered with language that makes it clear that, ultimately, it is the franchisee’s responsibility to ensure its compliance with federal and local disability laws.

Franchisors in the Hotel Industry have recently been targeted by litigants under the Trafficking Victims Protection Reauthorization Act (“TVPRA”), whereby victims of sex trafficking have tried to hold Franchisors of hotel chains responsible. Fortunately, showing that a hotel franchisor was not directly involved in such conduct, and had no reasonable awareness of the illegal acts, and the inability to plead that they directly “participated” in such an illegal venture, will often defeat such claims at the summary disposition stage of litigation. See, e.g., *A.B. v. Hilton Worldwide Holdings, Inc.*, 484 F.Supp.3d 921 (D.Or. Mar. 31 2021); *H.G. v. Inter-Continental Hotels Corp.*, 484 F.Supp.3d (ED Mi. 2020).

Finally, traditional agency liability as a basis for vicarious liability still remains a concern, and cases still abound where agency liability premised upon controls, largely unavoidable in a franchise business context, are used to justify negligence liability. See, e.g., *Domino’s Pizza, LLC v. Wiederhold*, No. 5D19-2343 (Fla Dis. Ct. App. Oct. 23 2020) (9 million jury verdict affirmed against franchisor based upon agency factors inherent in most franchise relationships) (but see *Dissent*, noting issues in franchising and “day to day” operations not provided in jury instruction). There is no absolute shield, and a lawsuit can always be filed, regardless of its merit. However, the degree of control exerted over franchisees, is well within a franchisor’s decision-making power. Franchisors can greatly reduce their risk when they really take care to only become involved in operational issues critical to the day-to-day management of the system and maintaining its standards, avoid employment issues, and, with the aid of knowledgeable counsel, properly memorialise the responsibilities of franchisees.

11 Currency Controls and Taxation

11.1 Are there any restrictions (for example exchange control restrictions) on the payment of royalties to an overseas franchisor?

Foreign franchisors that expand their reach into the U.S. usually set up a U.S.-based subsidiary or Master Franchisee, which is granted a licence to the trademark and the right to sell franchises

in the U.S. So, most often, U.S. franchisees pay their royalties to the U.S.-based subsidiary or Master Franchisee. U.S. law does not impose any restrictions on a U.S. franchisee’s ability to pay royalties to an overseas franchisor. The rare exception to this would be where the franchisor’s home country is subject to U.S. economic sanctions.

11.2 Are there any mandatory withholding tax requirements applicable to the payment of royalties under a trade mark licence or in respect of the transfer of technology? Can any withholding tax be avoided by structuring payments due from the franchisee to the franchisor as a management services fee rather than a royalty for the use of a trade mark or technology?

Foreign franchisors that expand their reach into the U.S. usually set up a U.S.-based subsidiary or Master Franchisee, which is granted a licence to the trademark and the right to sell franchises in the U.S. So, most often, U.S. franchisees pay their royalties to the U.S.-based subsidiary or Master Franchisee. U.S. law does not impose any restrictions on a U.S. franchisee’s ability to pay royalties to an overseas franchisor. The rare exception to this would be where the franchisor’s home country is subject to U.S. economic sanctions.

11.3 Are there any requirements for financial transactions, including the payment of franchise fees or royalties, to be conducted in local currency?

The royalties paid by a U.S. franchisee to a foreign franchisor are considered U.S. source income and are subject to a 30% withholding tax (which must be paid directly to the Internal Revenue Service). If the U.S. has an income tax treaty with the franchisor’s home country, a lower tax rate may apply. There is no advantage to structuring the royalties as management service fees since such fees are subject to the same 30% withholding tax. To obtain the full benefit of its royalty rate, the franchisor may try to negotiate a “gross-up” provision in the franchise agreement that requires a U.S. franchisee to make up the difference and pay at, or close to, the full royalty rate.

12 Commercial Agency

12.1 Is there a risk that a franchisee might be treated as the franchisor’s commercial agent? If so, is there anything that can be done to help mitigate this risk?

Yes, there is a risk of vicarious liability, and the franchisor cannot simply eliminate that risk by inserting a clause in the franchise agreement stating that the franchisee is an “independent contractor” (and not an agent). A franchisor that retains the right to exercise control over the day-to-day business operations of its franchisee(s) may inadvertently create an actual agency relationship between it and the franchisee. Even if a franchisor does not do that, courts may still find that a franchisee has apparent authority on behalf of the franchisor if an innocent third party: (a) reasonably believes, based on the franchisor’s representation, that the subject franchisee is an agent of the franchisor; and (b) reasonably relies upon that belief to its detriment. The danger is that if a franchisee is found to be an actual or apparent agent of the franchisor, the franchisor may be held vicariously liable for certain harm caused by the franchisee’s actions (or failures to act). See also Section 10, Joint Employer Risk and Vicarious Liability, *supra*.

To minimise risk, the franchisor should refrain from exercising control over the franchisees’ day-to-day business operations and

only do what is necessary to maintain brand integrity and ensure uniformity and consistency throughout the system. To protect itself from a contractual standpoint, the franchisor should include in its franchise agreement: (a) an indemnification provision, obliging the franchisee to indemnify the franchisor; and (b) a provision requiring that the franchisee list the franchisor as an additional insured under the franchisee's insurance policy. The franchisor should also require that its franchisees hold themselves out to the public as independent owners on all of their marketing and advertising materials.

13 Good Faith and Fair Dealings

13.1 Is there any overriding requirement for a franchisor to deal with a franchisee in good faith and to act fairly in its dealings with franchisees according to some objective test of fairness and reasonableness?

It depends upon the jurisdiction. Many states, but not all, automatically incorporate by common law an implied covenant of good faith and fair dealing into every contract within their jurisdictions, including franchise agreements. A few do not, and a few only do so in limited non-franchise contexts, so it is important to analyse which state's law applies in a given circumstance. Where it exists, the implied covenant of good faith and fair dealing typically means that where one party may be free to exercise its discretion, it should not do so in a manner that deprives the other party of the benefit of the contract. It should not enrich itself unfairly, or act in an overly arbitrary or capricious manner, so as to eliminate the other party's benefit of the bargain. Notably, this does not quite act as an objective test of fairness and reasonableness, but rather one that bars one party from exercising a right in a way that unfairly deprives the other of the benefit of the bargain.

Generally, the implied covenant of good faith and fair dealing cannot conflict with an express contractual term. Therefore, a well-drafted franchise agreement will usually address most significant issues with sufficient particularity to minimise the application of the implied covenant of good faith and fair dealing. However, issues do arise, especially where the exercise of discretion is involved, and a franchise agreement is silent on the point in question. Further, good faith and fair dealing is a fact-driven analysis, and even well-drawn contracts may not anticipate every contingency. Therefore, where a franchisor wishes to retain the unfettered ability to make an important decision that may be to the significant detriment of a franchisee, it is prudent for a franchisor to make clear that it has the absolute discretion to do so within the contract, and thereby avoid the inadvertent application of the implied covenant of good faith and fair dealing.

In addition, a franchisor must be confident that the contract term under which it wishes to exercise discretion is enforceable. Even where a franchisor may be in a position to argue that an express term of a contract grants it absolute discretion to do something that negatively impacts a franchisee, there still remains a risk that an implied covenant of good faith argument could apply, especially if the contractual term the franchisor wishes to utilise or exercise is so one-sided as to be prohibited by statute, unconscionable, or otherwise void. One situation where the implied covenant of good faith and fair dealing often arises is where a franchisor may have the right to open new units, but in exercising discretion in the opening of new units, there is a negative impact upon existing franchisees. See, e.g.: *Michael D. Bryman, et al. v. El Pollo Coco, Inc.*, MC026045 (Cal. Super. Ct., L.A. Cty., Aug. 1, 2018) (jury verdict of \$8.8 million against the franchisor for violating the implied covenant of good faith and fair dealing when the franchisor placed competing units near franchisee, despite terms in franchise agreement that gave the franchisor that right) (settled on appeal); and *Kazji v. KFC US LLC*, 19-cv-3300-RBJ (D.Colo.,

May 17, 2021) (jury awarded damages of \$792,239 for breach of implied covenant of good faith and fair dealing due to a bad faith exercise of discretion in locating a new outlet too close to the existing franchise, and failing to perform a legitimate impact study in good faith). The lesson is that while contract law and a well-crafted agreement will do a great deal to insulate a franchisor from liability, they are not absolute shields and, in many jurisdictions, the implied covenant of good faith and fair dealing may apply to prevent overreaching by a party that clearly deprives the other party of the benefits of the deal.

To be clear, requiring good faith and fair dealing is not the same thing as requiring a franchisor to sacrifice its own economic self-interest in favour of the franchisee. Parties are generally free to enter into contractual provisions as they wish, especially if both parties are sophisticated and represented by counsel. Either the franchisor or the franchisee may knowingly enter into an unfavourable economic arrangement, and if the contract is clear, the implied covenant of good faith and fair dealing will generally not be allowed to contradict the express terms of the agreement. See, e.g., *ReBath LLC v. Footbills Service Solutions Company*, No. 21-cv-00870-PHX-DWL, 2021 WL 2352426 (D. Ariz. June 9, 2021) (the court acknowledged the "harsh" result, but refused to apply implied covenant of good faith and fair dealing over express terms of FA allowed termination after three defaults in a year, even if the defaults were cured); and *SAT Agyar, LLC v. 7-Eleven, Inc.*, No. 19-19994 (MAS) (ZNQ), 2021 US Dist. LEXIS 8617 (DNJ Jan. 15, 2021) (the franchisee's implied covenant argument rejected where parties had specifically amended FA to address change in ordinance prohibiting certain hours of operation).

There are other exceptions to contract law that may require good faith conduct. In addition to common law "good faith" requirements, some states have franchise "relationship" statutes that require good faith conduct on the part of a franchisor (see franchise "relationship" statutes, discussed in question 9.1, *supra*, and question 14.1, below). These specific state statutes can actually override or void contractual language, and prohibit, amongst other things, unfair or inequitable conduct by a franchisor. Some even require "good" reasons for termination, regardless of what the franchise agreement may say. See, e.g., MN Stat. §80C.14 (prohibiting unfair or inequitable conduct); NJ Stat. §56:10-7 (e) (prohibiting the imposition of "unreasonable" standards of performance on franchisees); CA Stat. BPC §20020 (requiring a "good faith" reason for termination). Many of these "relationship" statutes also contain "anti-waiver" provisions, which prohibit any attempt to waive or nullify their statutory protections through contractual language. See NJ Stat. §56:10-7(a) (anti-waiver provision). Additionally, a franchisor's conduct, if it is sufficiently unfair, may rise to the level of an "unfair and deceptive" act under other statutes (such as the FTC Act, discussed *supra* in section 3, and analogous state Little FTC Acts, see §9.1 *supra*).

While there may not be a blanket requirement in the U.S. that a franchisor conduct itself at all times with fairness and reasonableness, there are significant economic factors that also decidedly tilt towards treating franchisees fairly. Franchise systems that take unfair advantage of their franchisees may find themselves unable to sell new units if their franchisees are unsuccessful or unhappy. In the highly competitive U.S. franchise marketplace, negative reviews by franchisees can have a significant impact upon franchisors, especially since franchisors must disclose (in their FDDs) when their units close or fail. Franchisors must also disclose litigations against franchisees in their FDDs, so even if a franchisor prevails in litigating a dispute, prospective franchisees are apt to notice if franchisors have a significant number of litigations against their franchisees claiming bad faith on the part of a franchisor. Therefore, while there may not be a legal requirement to act fairly and reasonably in every instance, franchisors should think carefully before putting immediate economic gains before

the long-term health of the system, or exercising a right in a way that may put a franchised unit out of business, or create an image problem that can reduce future sales of franchised units.

Franchisors should be especially cautious in the current climate. Normally, requiring a franchisee to comply with certain provisions, or to strictly maintain system standards, would be well within the orbit of a franchisor's rights. However, many franchisees in the past few years may have been required to conduct business in accordance with emergency rules and regulations (e.g., governmental action regarding COVID-19 requiring deviation from system standards, hours of operation, staffing requirements, etc.), or to navigate unprecedented economic pressure and supply chain issues (making it impossible to timely pay fees, utilise only approved products or suppliers, or strictly comply with contractual obligations). Therefore, the blind use of a discretionary right by a franchisor to default or terminate a non-compliant franchisee, may give rise to potent claims under the implied covenant of good faith and fair dealing, particularly where a jury or finder of fact may feel especially sympathetic towards an aggrieved franchisee. Franchisees facing COVID-19 and supply chain disruption-related issues may have much better arguments excusing non-compliance, and will likely appear very sympathetic to a finder of fact if they were treated unfairly during these disruptive times. Franchisors may find the best course of action is to try and work with a franchisee, rather than default or terminate a franchisee, and risk a claim of breach of the implied covenant of good faith and fair dealing. Indeed, in states such as NJ (with the NJ Franchise Practices Act mandating "good cause" for termination, and prohibiting holding franchisees to an "unreasonable standard of performance" – *regardless of the express terms of a FA*), such a course of action may already be mandated. See, e.g., *SAT Aggar, supra*. The lesson is that these are unique times, and franchisors should be mindful that equitable arguments and mechanisms in the law requiring good faith and fair dealing are far more likely to be applied in these circumstances.

13.2 Is there any limitation on a good faith obligation being unenforceable if it only applies from franchisee to franchisor, rather than being mutual?

In jurisdictions where the implied covenant of good faith and fair dealing exists, it is mutual, automatically incorporated by law, and generally cannot overcome an express contractual term that establishes the parties' respective rights and obligations on a particular issue. However, there is not any overarching rule that overrides an express contractual term requiring a good faith obligation by only one party, to make the obligation mutual. As such, the implied covenant of good faith and fair dealing really functions as a "gap filler" in a contract, serving to require good faith performance where the parties did not envision or draft a contract to cover a circumstance that has arisen, or, where one party has discretion in how it performs under a contract, but the details are not specified by contract. The "implied covenant" will limit that discretion to be performed in good faith.

Where the implied covenant of good faith and fair dealing exists, most courts will not enforce a contract term that purports to waive application of the implied covenant of good faith and fair dealing generally, and, in some states, the franchisor may even be statutorily prohibited from engaging in bad faith conduct with its franchisees. In addition, the affirmative defence of "unclean hands" is often available in jurisdictions where an implied covenant of good faith and fair dealing is recognised, which will often bar a party who has engaged in bad faith conduct from trying to argue the other party breached an obligation of good faith and fair dealing.

In jurisdictions where the implied covenant of good faith and fair dealing does not exist, there may be some meaning to

requiring one party to perform an obligation "in good faith", particularly where the details of that performance cannot be specified in, or anticipated by, the terms of a contract, or where discretion is reserved by the performing party. However, this kind of quasi-subjective standard of performance leaves a lot to chance, which is generally not advisable for a franchisor who wants to have a uniform contractual scheme across a system. Other similar standards such as "commercially reasonable" and "best efforts" are similarly vague, albeit with different meanings, but critically leave performance issues to later interpretation by a finder of fact. Well-drafted franchise contracts, particularly on critical issues, should properly delineate a party's actual obligations, rather than leave them to chance. If a franchisor wants to avoid a "good faith" obligation, or wants it to only work "one way" in a specific circumstance, it should expressly set forth the parties' rights and obligations in the contract.

14 Ongoing Relationship Issues

14.1 Are there any specific laws regulating the relationship between franchisor and franchisee once the franchise agreement has been entered into?

The FTC Franchise Rule's disclosure laws do not regulate the conduct of the franchisor after a franchise relationship has been established. However, 21 states, D.C., Puerto Rico and the U.S. Virgin Islands have enacted relationship laws that govern the substantive aspects of the franchise relationship after the offer and sale of the franchise is completed. Relationship laws generally address: (i) regulating the franchisors' ability to terminate or refuse renewal of the franchise agreement; (ii) the imposition of restrictions on transfer; (iii) granting franchisees the right to form an association with other system franchisees; (iv) prohibiting franchisors from discriminating against similarly situated franchisees without cause, including selective contract enforcement; (v) restrictions or prohibitions on the franchisor from directly or indirectly (for example, through another franchisee) encroaching upon a franchisee's territory; and (vi) obligations of the franchisor to repurchase inventory upon termination or non-renewal of the franchise. While the specifics of each states' franchise relationship laws vary, their common goal is to protect franchisees for the duration of the business relationship from the unequal bargaining power that typically favours franchisors. Alaska, Arkansas, California, Connecticut, Delaware, Hawaii, Illinois, Indiana, Iowa, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, North Dakota, Rhode Island, Virginia, Washington and Wisconsin currently have relationship laws.

While there is no generally applicable federal franchise relationship law, there are both federal and state laws that govern franchise business relationships in specific industries, including: gas station operations; automobile dealerships; hardware distributors; real estate brokerage firms; farm equipment machinery dealerships; recreational vehicle dealerships; and liquor, beer and/or wine distributorship. For example, under the Federal Petroleum Marketing Practices Act, gas station franchisors or refiners cannot terminate the relationship with franchisees without first having "good cause". Good cause in relationship laws generally means that the franchisee has not "substantially complied" with the material terms of the agreement or has engaged in acts that have damaged the franchisor. Such acts, include, but are not limited to the franchisee: (i) voluntarily abandoning the franchised business; (ii) becoming insolvent; or (iii) selling competing goods. If sufficient grounds for termination exist, some states may additionally require the franchisor to provide the franchisee with notice of termination (60 days advance notice is a common requirement) and give the

franchisee an opportunity to cure such violations (cure periods typically range from 30 to 90 days). If a franchisor elects not to renew a franchise agreement, the franchisor (under certain circumstances) may be required to either: (i) offer to buy the franchise, if the franchisee owns the gas station; or (ii) give the franchisee the opportunity to purchase the premises from the franchisor, if the franchisor owns the gas station.

There are also 28 states that have enacted unfair trade practice acts (Little FTC Acts) that grant “consumers” a private right of action under state law if a franchisor engages in unfair trade practices in violation of corresponding federal law (for example, a Little FTC Act would provide a private right of action where there is a violation of the federal FTC Act of FTC Franchise Rule). Alabama, Alaska, Arizona, Connecticut, Florida, Georgia, Hawaii, Illinois, Louisiana, Maine, Maryland, Massachusetts, Mississippi, Montana, New Hampshire, New Mexico, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Utah, Vermont, Washington and West Virginia each have Little FTC Acts.

Furthermore, U.S. courts have generally upheld applying the implied covenant of good faith and fair dealing (typically used to interpret commercial contracts) to franchise agreements. The Implied Covenant of Good Faith and Fair Dealing requires each of the contracting parties to perform their contractual obligations in a way that is not inconsistent with the other party’s reasonable business expectations or that would prevent the other party from enjoying the “benefit of the bargain”.

Since relationship laws vary, it is essential to determine which state’s relationship laws apply. Most states, though not all, address jurisdiction in their relationship laws. Among the states that address the jurisdictional application, some apply jurisdiction more broadly than others. Some states, such as New Jersey, require the franchised unit to be located in its state for its relationship laws to apply. Other states apply a broader scope, allowing its relationship laws to apply if the franchisee is a resident of or is domiciled in the state, while others apply an even broader scope.

15 Franchise Renewal

15.1 What disclosure obligations apply in relation to a renewal of an existing franchise at the end of the franchise agreement term?

The FTC Franchise Rule requires franchisors to furnish *all* prospective franchisees with an FDD prior to consummating the sale of a franchise (see question 1.2 above regarding disclosure obligations). However, the franchisor is not required to provide disclosure to a franchisee who is either: (i) exercising its rights under the existing franchise relationship to establish new outlets; or (ii) renewing or extending its franchise relationship by extending the term of its present franchise agreement or entering into a new franchise agreement, unless the terms and conditions of the new (or extended) franchise agreement are materially different from those under the previous franchise agreement, or if the circumstances surrounding the franchisor and its business have materially changed (e.g., there are changes: in ownership; to financial disclosures; in the number of outlets opened and closed; and to the royalty and marketing fund contribution rates, etc.), in which case disclosure of the FDD is required.

Franchisors must also pay heed to state disclosure laws that have provisions addressing the disclosure requirements in connection with renewal (i.e., California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Rhode Island, and Virginia). For example, most state laws require re-disclosure where there is an interruption in the business by the franchisee, whereas others state laws require disclosure if the terms if the

franchise relationship under the renewal agreement is materially different from those under the previous agreement.

15.2 Is there any overriding right for a franchisee to be automatically entitled to a renewal or extension of the franchise agreement at the end of the initial term irrespective of the wishes of the franchisor not to renew or extend?

States generally acknowledge parties’ freedom to negotiate the terms for renewal or extension of the franchise agreement. However, some states have franchise “relationship laws” that restrict the franchisor’s right or ability to refuse to renew a franchise agreement. The restrictions imposed by these relationship laws vary from state to state. Several states require that the franchisor: (i) have “good cause” or “just cause” to refuse renewal of a franchise agreement (e.g., California, Connecticut, Hawaii, Illinois, Indiana, Michigan, Minnesota, Nebraska, New Jersey, Rhode Island and Washington); (ii) provide franchisees with at least 90 days’ (e.g., Delaware, Mississippi and Missouri), and in some cases, six months’ (e.g., in Connecticut where the non-renewal is based on a determination to not continue to lease property to the franchisee), prior notice of the franchisor’s intent to not renew the franchise agreement; (iii) repurchase the franchisee’s assets (e.g., Arkansas, California, Connecticut, Hawaii, Maryland, Rhode Island, Washington and Wisconsin); and/or (iv) waive any post-term non-competition restrictions (e.g., California). While the goal of these relationship laws is to protect franchisees from the arbitrary termination or non-renewal of the franchise relationship, such relationship laws often have the side effect of creating perpetual franchises. However, in each case, a franchisee may choose not to renew its franchise agreement.

15.3 Is a franchisee that is refused a renewal or extension of its franchise agreement entitled to any compensation or damages as a result of the non-renewal or refusal to extend?

If a franchise agreement is for a defined term without any right of renewal and the franchisor is not in breach of the franchise agreement, if the franchisee and franchisor do not agree to renew the franchise agreement then, typically, the franchisee will have no claim for damages relating to the non-renewal. However, there are circumstances under the law where a franchisee may seek damages if a franchisor fails or refuses to renew the franchise agreement, including, for example, where a franchisor: (i) breaches a contract provision pursuant to which the franchisee has a right to renew its agreement; or (ii) violates a state relationship law that restricts the franchisor’s right to fail or refuse to renew a franchise agreement.

Several state relationship laws provide for recovery of the fair market value of the business if the franchisor unlawfully fails or refuses to renew the franchise agreement. For example, in New Jersey, if a franchisor fails to renew or terminates a franchisee in violation of the New Jersey Franchise Practices Act, it must reimburse the franchisee for its loss and pay damages equal to “the actual or reasonable value of the franchisee’s business when the franchisor cuts off the franchise”. *Westfield Ctr. Serv. v. Cities Serv. Oil Co.*, 86 NJ 453, 465-466 (1981). In addition, some state relationship laws require franchisors to repurchase the franchisee’s business assets (in whole or in part) when a franchise agreement is not renewed. For example, in Iowa, a franchisor must repurchase the franchisee’s assets at fair market value as a going concern. In Washington, franchisors are required to compensate franchisees for goodwill, unless the franchisor agrees (in writing) that it will not enforce the non-competition provision in the franchise agreement. In Arkansas, Hawaii and Washington, the franchisor is obligated

to repurchase the franchisee's inventory, supplies, equipment, and furnishings. In California, the franchisor is only required to repurchase the franchisor's inventory, whereas Hawaii requires that the franchisor repurchase inventory from the franchisee upon termination of the franchise agreement, whether or not termination was for good cause.

16 Franchise Migration

16.1 Is a franchisor entitled to impose restrictions on a franchisee's freedom to sell, transfer, assign or otherwise dispose of the franchised business?

Yes. Franchisors typically provide in their franchise agreement that franchisees are not permitted to transfer or assign any interest in the franchise agreement (or in the ownership interest in the franchisee) without the prior written consent of the franchisor. Franchisors in the U.S. are permitted to impose reasonable restrictions or "conditions" in connection with a proposed transfer of the franchised business. Examples of such conditions typically include: (a) requirements imposed on the existing franchisee (e.g., being current on all of its financial obligations to the franchisor, not being in default of the franchise agreement, the payment of a transfer fee, and the delivery of a general release in favour of the franchisor); and (b) requirements imposed on the transferee franchisee (e.g., entering into the franchisor's "then current" franchise agreement, meeting certain financial criteria, and completing the franchisor's required initial training programme).

Many franchisors also provide in their franchise agreement that they will have a "right of first refusal" with respect to proposed transfers of the franchised business to third parties. This right is frequently waived by franchisors as they are not usually interested in "taking over" additional locations that are in their system by purchasing them at fair market value. However, as many franchisors will not waive their right of first refusal "upfront" (e.g., before a deal between the franchisee and prospective transferee is negotiated), the fact that the franchisor has the "right of first refusal", generally has a "chilling effect" on the franchisee's ability to sell, because the proposed purchaser must spend considerable time, effort and money negotiating the deal with the franchisee and entering into an agreement, only to find that "its" deal has been usurped pursuant to the franchisor's "right of first refusal". If prospective purchasers are represented by knowledgeable franchise counsel, counsel may inquire as to whether the franchisor is willing to waive the right of first refusal "upfront" and if it is not, counsel may advise his or her client to move on to another deal.

Several state relationship laws impact a franchisor's ability to impose restrictions on the franchisee's ability to transfer its business. For example, some relationship laws provide that it is an unfair or deceptive act for a franchisor to refuse to permit a transfer without having "good cause". Others permit a franchisor to reject a proposed transfer if the transferee fails to satisfy the franchisor's then-current requirements, as long as the franchisor's refusal is not arbitrary. Other relationship laws require the franchisor to provide a timely response to a franchisee's request to transfer and if the franchisor denies the request, it must provide the franchisee with a "material" reason for the rejection, such as the proposed transferee's failure to meet the franchisor's standard requirements relating to financial ability, business experience or character. Some relationship laws provide that in the event of the death or disability of the franchisee (or franchisee's principal, if franchisee is an entity), the franchisee's spouse or heirs will have reasonable time and opportunity to elect to operate or own the franchised business, so long as the spouse or heir satisfies the franchisor's various then-current standards and requirements for operating the franchise.

16.2 If a franchisee is in breach and the franchise agreement is terminated by the franchisor, will a "step-in" right in the franchise agreement (whereby the franchisor may take over the ownership and management of the franchised business) be recognised by local law, and are there any registration requirements or other formalities that must be complied with to ensure that such a right will be enforceable?

Many franchise agreements in the U.S. contain provisions that provide that the franchisor, under certain circumstances, has a right to "step-in" and take over the operation and management of the franchised business. This may be for a limited period of time, for example, where a principal owner passes away and the franchised business has no manager in place to properly manage the business or where the business has been experiencing operational difficulties. If this occurs, and where the franchise agreement provides that the franchisor may take over the operations of the franchised business (for the benefit of the franchisee), the franchisor may do so and will typically have the right to retain an agreed upon "management fee" for its services. The franchisor may also have the right to declare that it is terminating the franchise agreement. If this occurs, it is common for the franchise agreement to grant the franchisor an option, but not necessarily an obligation, to purchase the assets of the franchised business pursuant to a defined formula, which formula may often provide for the purchase of assets for less than market value. However, if a state relationship law is applicable, it may call for a more favourable result for the franchisee and would likely override any less favourable provision contained in the franchise agreement. Reasons for asserting such "step-in" rights, whether "short term" or as a result of termination, include where a franchisee is failing financially, has abandoned the franchised business, or where the franchisee (or its principal(s)) has engaged in egregious and/or criminal conduct that is likely to negatively affect the brand's reputation or goodwill. This may include the franchisee knowingly defrauding the franchisor, using the brand's trademarks for unauthorised purposes or being found guilty of a felony or crime of moral turpitude. Such "step-in" provisions, which must be disclosed in the franchisor's offering prospectus (FDD) given to prospective franchisees, are typically provided for in the franchise agreement and are generally enforceable. Where the franchisee is going to be leasing the franchised business premises (as in most cases), the franchisor should require that the franchisee enter into a "Collateral Assignment of Lease" agreement (typically, a three-party agreement between the franchisor, franchisee and the landlord), which will provide for the various circumstances in which the franchisor will be permitted to assert its "step-in" rights. If such an agreement is entered into (or the landlord otherwise consents in writing, such as in a lease rider or lease amendment), the franchisor will likely be able to enforce its "step-in" rights, including the right to take an assignment of the franchisee's lease.

While there are no registration requirements or formalities that must be complied with in connection with a franchisor's enforcing its "step-in" rights (other than complying with "notice" requirements contained in the franchise agreement), the franchisee and/or the landlord (if no "step-in" rights have been provided for in a lease rider or amendment) may object to or seek to frustrate the franchisor's attempts to assert "step-in" rights. In such case, the franchisor would usually not be permitted to use any form of "self-help" (under governing state law) and it is likely that it would be forced to seek injunctive relief in the courts. Where the franchisee files for federal bankruptcy protection before a franchisor tries to enforce its "step-in" rights, the bankruptcy filing typically results in the triggering of an "automatic stay" under bankruptcy law, which will initially protect the debtor/franchisee. Under those circumstances, the franchisor would have to petition the

bankruptcy court to seek to enforce its “step-in” rights. However, this process could take several weeks or even months.

16.3 If the franchise agreement contains a power of attorney in favour of the franchisor under which it may complete all necessary formalities required to complete a franchise migration under pre-emption or “step-in” rights, will such a power of attorney be recognised by the courts in the jurisdiction and be treated as valid? Are there any registration or other formalities that must be complied with to ensure that such a power of attorney will be valid and effective?

Franchisors do not generally use basic powers of attorney in attempting to enforce “step-in” rights, which are provided for in the franchise agreement. Rather, as explained above at question 16.2, franchisors often use a “collateral lease assignment” in order to protect and enforce their “step-in” rights. However, franchisors do commonly use agreements that appoint the franchisor and perhaps “any officer or agent of franchisor” as attorney-in-fact (e.g., holder of a power of attorney), in connection with providing for the orderly (and peaceful) transfer of certain assets of the franchised business which franchisor believes that it has a right to retain after the franchisee no longer has the right to operate the franchised business. These include such assets as telephone numbers, fax numbers, and internet domain names, etc., used by the franchised business. These issues typically arise in the context of an involuntary transfer or termination of the franchised business (as opposed to an approved transfer of the franchised business, which is requested by the franchisee, where the approved transferee will continue operating the business). Such agreements authorising the franchisor to take such action as “attorney-in-fact” are generally enforced.

17 Electronic Signatures and Document Retention

17.1 Are there any specific requirements for applying an electronic signature to a franchise agreement (rather than physically signing a “wet ink” version of the agreement), and are electronic signatures recognised as a valid way of creating a binding and enforceable agreement?

In 2000, the United States Congress passed the Electronic Signatures in Global and National Commerce Act (“ESIGN”), confirming that electronic signatures have the same legal status as “wet ink” signatures. In order to be a valid electronic signature, it is essential that, among other things: (i) each party intends to sign the document; (ii) the signature must be associated with the applicable document; and (iii) in certain consumer situations, the contracting parties must consent to do business electronically. ESIGN pre-empts state laws regarding electronic signatures whenever inconsistent to do so. ESIGN does not mandate the use of electronic signatures, but it affords parties the option.

If the franchise agreement is a deed (not frequently the case), further formalities such as needing to be executed in front of a witness are required. The witness must be present to witness the signing of the document, and there is no current authority on whether the requirement that the witness be present to see the signing can be satisfied by virtual means under normal circumstances. During the COVID-19 era, 46 states have passed laws or temporarily rules that allow the remote witnessing of deeds and counterpart signatures. As COVID-19 measures have subsided or expired, 38 states have enacted some form of permanent remote online notarization (“RON”) law. In May 2021, the “Securing and Enabling Commerce Using Remote and Electronic Notarization

Act of 2021 (the “SECURE Notarization Act”) was re-introduced in the U.S. Senate, with the aim of establishing standards for electronic and remote notarisations that affect interstate commerce. In June 2021, the same bill was introduced in the U.S. House. The bipartisan RON bill, if passed, would authorise every notary in the country to perform remote online notarisations for interstate commerce purposes. The bill remains stalled in committee.

While best practices would usually still suggest that the franchise agreement be signed in “wet ink”, so that the witnessing of the signature is less able to be challenged, it is vital to research each state’s current laws, to explore what options are available.

17.2 If a signed/executed franchise agreement is stored electronically (either having been signed using e-signatures or a “wet ink” version having been scanned and saved as an electronic file), can the paper version of the agreement be destroyed?

A franchise agreement that is currently in effect must be retained in either electronic or hard copy for the duration of the contractual term. Once expired, best practices and Internal Revenue Service guidelines recommend a retention period of 10 years. Franchisors also must retain a copy of each materially different version of their FDD and also a copy of the signed receipt, both for at least three years after the close of the fiscal year when the documents were last used. Many states impose similar, if not stricter, requirements.

Franchisors should also maintain e-signed or “wet ink” copies of executed franchise agreements even if they have been scanned and saved. While many states allow for such document retention to be digital rather than “wet ink”, and the FTC Franchise Rule does not specify a preference, it is prudent to keep “wet ink” versions of these important documents. From an evidentiary perspective, a “wet ink” version provides the best evidence in the event a dispute arises.

18 Current Developments

18.1 What is the biggest challenge franchising is facing in your jurisdiction and how are franchisors responding to that challenge?

The COVID-19 outbreak, which was declared a pandemic in March 2020, created a global health emergency and devastated economies worldwide. In 2020, the U.S. economy contracted at a rate of 3.5%, representing the worst economic downturn in the U.S. since World War II. The hospitality, personal services and restaurant franchising industries were hit particularly hard, and, depending on the local law and the severity of the COVID-19 pandemic, retail stores across the U.S. were forced to either remain closed or operate under significant restrictions. Even now (the summer of 2022), COVID-19 is not “over” and there are still risks that the virus will further mutate in the future. However, the development and distribution of effective vaccines in the U.S. has, for all intents and purposes, opened up the U.S. economy and for many, restored a sense of “business as usual”. According to the IFA, U.S. franchising activity has resurged back to pre-pandemic levels in 2021. The strong labour market, increased consumer spending, government stimulus and eased monetary policy all contributed to the impressive growth of franchising in 2021.

That being said, the pandemic has had an indelible impact on consumer behaviour. Perhaps, most importantly, it forced consumers to spend significantly more time in their homes, expend more resources there, and shop online more than they did pre-pandemic. Even now, many professionals are still working remotely from home on a part-time or full-time basis. According

to one study conducted by Upwork, a staggering 22% of the workforce will continue to be remote in 2025. As a result of these factors, franchised businesses have been forced to re-evaluate their marketing approaches to reach customers who no longer commute into urban areas for work every day, and some of them are still not experiencing pre-pandemic revenues and growth, as the level of foot traffic that they enjoyed prior to the pandemic has not yet returned.

To reach customers who were homebound during the worst months of the pandemic in the U.S., many restaurants began offering takeout menus and delivery services. Food delivery services became thriving businesses (some franchised) in their own right. Fitness and gym franchises introduced virtual workout sessions in order to retain members. Whether these and other changes reflect a paradigm shift in consumer behaviour and in franchise business models and operations will depend, in part, upon the degree to which the shift to a remote, virtual economy continues to occur, and whether consumers are satisfied with the offerings presented. Regardless, all businesses, including franchisors, need to continue to re-think their commercial footprints, explore how they can maximise the use of their retail locations, and keep adjusting or expanding their offerings to meet the needs of consumers in a post-pandemic, and increasingly digitised world.

In 2022, certain geopolitical and economic events have led to significantly increasing costs and prices, which in turn, are placing stresses on the bottom lines of franchises (and other businesses). Franchisees must now contend with rising inflation, higher energy costs (due, in significant part, to the ongoing Russia-Ukraine war), supply chain disruptions (due, in large part to the COVID-19 pandemic lockdowns in China), and labour shortages.

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Rosen Karol Salis, PLLC (formerly known as The Richard Rosen Law Firm, PLLC) and its predecessors have been providing high-quality legal services in the franchise field for over 40 years from their offices located in New York City. Our firm has represented franchisees, franchisors and franchisee organisations in virtually all areas of franchise law, from setting up franchising systems and programmes, forming all entities, drafting and negotiating (on all sides) franchise and multi-unit development agreements, disclosure and other ancillary documents, to mediating, arbitrating and litigating in both state and federal courts. Our firm negotiates leases, agreements for the sale or acquisition of franchise-related real estate, financing documents and handles all matters applicable to franchise transactions. We have represented franchisors and franchisees in virtually all fields, including restaurants, real estate brokerage, healthcare, fast food, fitness, energy, hospitality, education, health and beauty, telecommunications, senior care, courier services, apparel and many more. Rosen Karol

Salis, PLLC is highest rated by Martindale Hubbell and amongst franchise law firms in the U.S. In 2018, 2019 and 2020, we were named Franchising Law Firm of the Year in the USA by *Lawyers Worldwide Awards Magazine* and in 2020 we were recognised as the Best Franchise Law Firm by *Global Magazine* and the *Global Organization*.

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