Guiding You Through the Legal Maze.℠

OUTLOOK FOR FRANCHISING IN EUROPE

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I. Current Level of Franchising Activity in Europe

A. The International Franchise Association Educational Foundation, Inc. and Horwath International have recently published *Franchising in the Economy 1988-1990*. This is the only reliable continuing source of statistical information and trends in U.S. franchising. The U.S. Department of Commerce previously prepared an annual report on franchising but decided to suspend the publication as part of its privatization program.

B. The results, compiled by surveys of IFA member firms, include the following statistics regarding international franchising by U.S. franchisors as of 1988:

1. The Forward of the Report indicates: "[Franchising] will constitute a major presence in the European Common Market when it comes into full effect."

2. In 1988, 374 U.S. franchisors (17% of all U.S. business format franchisors) were operating outside of the Untied States with more than 35,000 outlets in countries outside the United States.

3. An additional 1.7% of business format franchisors are considering operating in foreign countries by the end of 1990.

4. In 1988, there were 2,843 franchised and company-owned units in the United Kingdom and 4,975 franchised and company-owned units in continental Europe for a total of 7,818 franchised and company-owned units in the EEC.

5. Franchised units are being opened twice as fast as the number of company-owned units.

6. The percentage of income derived by the 374 U.S. franchisors operating outside the United States is as follows:

Number of Franchisors	**Percentage of Income Outside the U. S.**
27	More than 10%
46	5% - 9%
128	1% - 4%
173	Less than 1%

7. 88.2% sold directly or through master franchise agreements.

II. Historical Background

The countries comprising the EEC do not (as of this time) have franchise registration and/or disclosure laws similar to our FTC Franchise Rule and our state franchise laws. France is currently considering a franchise disclosure law (see Part IV below). In general, franchising and other business agreements are subject to the following laws:

- Article 85 of the Treaty of Rome; and
- The Competition Laws of each member country

A. **<u>Article 85 of the Treaty of Rome</u>**

1. Article 85(a) of the Treaty of Rome provides that agreements between enterprises, any decisions by associations of enterprises and concerted practices which are likely to affect trade between Member States and which have as their object or result the prevention, restriction or distortion of competition within the Common Market and in particular those consisting in:

(a) The direct or indirect fixing of purchase or selling prices or any other trading conditions;

(b) Limitation or control of productions, markets, technical development or investments;

(c) Market sharing or sources of supply;

(d) The application to parties to transactions of unequal terms and respect of equivalent supplies, thereby placing them at a competitive disadvantage; or

(e) The subjecting of the conclusion of contracts to the acceptance by a party of additional supplies which, either by their nature or according to commercial usage, have no connection with the subject of such contract.

2. Any agreements or decisions prohibited pursuant to Article 85 are automatically void under Article 85(2).

3. An agreement that restricts competition within the EEC is not prohibited under EEC competition laws if it meets the standards of either the "De Minimis Notice" or Treaty Article 85(3).

4. The De Minimis Notice defines agreements that have a negligible effect on competition and, thus, do not infringe upon Article 85(1). According to the De Minimis Notice, Article 85(1) is not violated if:

(a) The parties to the restrictive agreement or practice, including their affiliates, have combined annual gross revenues of under 200,000,000 European Currency Units (ECUs) (U.S.$1.24 as of April 1, 1988); and

(b) The products covered by the agreement do not account for more than 5% of the volume in the relevant market.

5. If the franchising parties cannot meet the standards of the De Minimis Notice, they can seek an exemption from Article 85(1) by meeting the requirements of Article 85(3),

which provides for an individual exemption if the agreement meets the following four conditions:

(a) It improves the production or distribution of goods or promotes technical or economic progress;

(b) It reserves to consumers a fair share of the resulting economic benefits;

(c) It contains only indispensable restrictions; and

(d) It does not eliminate competition all together.

6. Violation of Article 85(1) can result in:

(a) Automatic civil unenforceability of the infringing provisions;

(b) Exposure of the parties to fines imposed by the EEC Commission; and

(c) Exposure of the parties to third party claims for damages.

The Commission may impose fines ranging from 1,000 to 1,000,000 ECU, or up to 10% of the participating parties' annual worldwide sale of all products from the preceding business year, whichever amount is higher.

From 1958 (when the Treaty of Rome became effective) until 1986, U.S. franchisors operating in Europe assumed and analogized that the U.S. antitrust concepts, particularly the Rule of Reason for vertical restraints, would apply in the international franchising context. Franchising in Europe really only starting taking hold in the 70s. In the mid-1980s, a number of franchise systems were operational, many of which were patterned after the U.S. franchise concept, including certain vertical restraints on franchisees deemed reasonable and necessary under U.S. laws. In 1986, this assumption, and franchising in general, were finally tested in court, as hereinafter discussed.

B. **Competition Laws**

1. In addition to complying with Article 85 of the Treaty of Rome, the competition laws of the member country must also be examined.

2. Part IV hereof contains a brief summary of member country laws affecting franchising.

C. **Pronuptia and Its Progeny**

1. **Pronuptia de Paris.** This was the Court of Justice's first opportunity to rule on the restraint of trade aspects of franchise agreements. Pronuptia de Paris, a French franchisor of wedding dresses and accessories, sued its German franchisee for failure to pay royalty fees. The franchisee defended alleging that the franchise agreement violated Article 85(1) of the Treaty of Rome and that Commission Regulation 67/67 - the block exemption for certain exclusive dealing arrangements - did not apply. The Court ruled that distribution franchise agreements are unique, because they use a single trademark, apply uniform commercial methods and require royalty payments, and therefore go beyond exclusive or

selective distribution systems. The Court held that restraints on competition imposed on franchisees, which are strictly necessary to protect the communication or know-how and the franchisor's interest in its application and the preservation of the identity and reputation of the network symbolized by their mark were "ancillary restraints" and do not constitute serious restrictions of competition under Article 85(1). The specific restrictions at issue included approval of franchisee advertising, uniform shop design, requiring the franchisee to devote the shop primarily to the sale of bridal fashion items, purchase of supplies from the franchisor or an approved supplier, restricting the franchisee from selling from other than at the shop, and equipping the shop, training of staff, sales techniques, purchasing and marketing in accordance with the franchisor's specifications.

2. **Yves Rocher.** In a companion decision rendered the same day as Pronuptia, the Commission also exempted from Article 85 the franchise agreement used by Société Yves Rocher, a French manufacturer and retailer of cosmetics, which distributes both through mail order and through approximately 1,000 franchised units known as "Yves Rocher Beauty Centres." The Commission held that the provisions in the franchise agreement that were either necessary to protect know-how or other assistance from benefiting competitors or to preserve the common identity and reputation of the franchisor's system were not restrictions on competition under Article 85(1). The Commission specifically held that, due to the nature of the Yves Rocher system, the obligation of the franchisee to sell only products bearing the Yves Rocher trademark was not a restriction on competition. The Commission also held that the allocation of exclusive territories to franchisees increased Yves Rocher's ability to compete with its competitors.

3. **Computerland.** In 1987, the Computerland standard franchise agreement was reviewed by the Commission. Under the Computerland franchise agreement, the franchisee is required to operate exclusively at an approved location with a protected area having a radius of less then one kilometer. With the consent of Computerland and upon payment of a reduced initial fee, the franchisee may be permitted to open "satellite" outlets offering approved products, provided such units are not located in another franchisee's protected area. The franchisee is required to sell only products and services acceptable to Computerland but can buy from any approved supplier. The Commission required that the in-term non-competition clause in the franchise agreement be modified to allow franchisees to acquire financial interests in competitors provided that a controlling interest was not obtained. The Commission also required that the post-term non-competition covenant be reduced to one year after termination within a radius of ten kilometers of the former franchisee's store. In Computerland, the Commission exempted two "area development agreements." This aspect of the Computerland decision indicates that the Commission recognizes that multi-unit master franchise agreements can have the same pro-competitive effects as single unit franchise agreements, and, therefore, can also quality for exemption under Article 85(1).

4. **ServiceMaster.** In August, 1988, the Commission exempted the franchise agreement of ServiceMaster Limited (England). ServiceMaster franchisees perform housekeeping, cleaning and maintenance services for commercial and residential customers using the franchisor's methods and trademarks. The franchise agreement had a location clause with a designated territory, but ServiceMaster reserved the right to operate itself or grant franchises to other franchisees within the designated territory. The franchise agreement also reserved to ServiceMaster the right to enter into contracts with national and multi-national customers and that the franchisee can be required to perform the services

agreed to under such contracts. The franchise agreement also provided that the franchisee cannot actively solicit customers outside its own territory but is permitted to provide services to customers located outside its territory. The franchisee may only purchase the brand and types of cleaning and other equipment that are approved by ServiceMaster and must purchase certain chemicals used in the operation of the business only by ServiceMaster or approved suppliers. The non-competition covenants provided that during the term of the franchise agreement the franchisee may not acquire a financial interest in a competing company, except for the ownership in 5% or less of the issued shares of publicly-held companies. After termination of the agreement the franchisee is prohibited for a period of one year from engaging in a business competitive with ServiceMaster within any territory within which it has provided services during the term of the franchise agreement. Outside of these territories for one year the franchisee may not solicit any customers who are customers of it during the two-year period prior to termination of the franchise agreement. The Commission held that these restrictions were not in violation of Article 85(1).

III. **Block Exemption Regulation on Franchising**

A. According to the EC Commission, the Pronuptia, Yves Rocher, Computerland and ServiceMaster decisions represented a series of "test cases" to be used in formulating a general block exemption of franchise agreements from the competition rules of the EEC. Regulation 19/65 authorizes the Commission to grant blanket or "block" exemptions for categories of agreements that have as their object the exclusive distribution or exclusive purchase of goods or include restrictions imposed in relation to the assignment or use of industrial property rights.

B. Commission Regulation 4087/88 (the "Franchising Block Exemption") was adopted by the Commission on November 30, 1988, and effective from February 1, 1989 until December 31, 1999. By complying with the terms of the Franchising Block Exemption, franchisors will gain automatic exemption from Article 85 of the Treaty of Rome. The following summarizes what provisions must, can and cannot be incorporated into franchise agreements under the Franchising Block Exemption:

1. **Scope of Coverage.** The Franchising Block Exemption applies to distribution franchises concerning the sale of goods and service franchises concerning the rendition of services (*i.e.*, business format franchises). It does not apply to industrial franchise agreements concerning the manufacturing of goods, that is, it does not apply to wholesale franchises. Wholesalers may benefit from other block exemptions if they fulfill the necessary conditions (*e.g.*, the "Know-How Regulation" No. 556/89). The Franchising Block Exemption also does not apply to motor vehicles, service stations and beer supply, which are subject to specific block exemption regulations. The Franchising Block Exemption covers single-unit franchise agreements between the franchisor and the franchisee as well as the multi-unit agreements between the franchisor and a master franchisee, such as area development agreements and international master franchise agreements.

2. **Definitions.** Article 1 contains definitions of the following terms: "franchise," "franchise agreement," "master franchise agreement," "franchisor's goods," "contract premises," "know-how," "secret," "substantial" and "identified." The Franchising Block Exemption provides that there are three elements to a franchise: (i) the use of a common name or a sign and a uniform presentation of contract premises; (ii) the communication by the franchisor to the franchisee of substantial know-how; and (iii) the continuous provision by the franchisor to the franchisee of commercial or technical assistance.

3. **Permissible Restrictions.** Article 2 allows the following restrictions on competition (which are normally included in many U.S. franchise agreements):

(a) A franchisor can agree not to do any of the following in the exclusive territory:

(i) Not grant another franchise to another franchisee;

(ii) Not compete with the franchisee; and/or

(iii) Not supply competing goods to any third parties.

(b) A master franchisee/area developer may agree not to grant franchises outside of the exclusive territory.

(c) A franchisee may agree to:

(i) Only operate the franchise from a specific location;

(ii) Not solicit customers outside the exclusive territory; and/or

(iii) Not manufacture, sell or use in the course of providing services goods competing with the franchise goods (this does not include spare parts or accessories).

4. **Conditionally Permitted Obligations.** Article 3(1) allows additional permitted obligations to be imposed upon franchisees insofar as these obligations are necessary to protect the franchisor's industrial or intellectual property rights or to maintain the common identity and reputation of the franchise network. These obligations are:

(a) To require the franchisee to sell or use in the course of providing services, exclusively goods meeting the franchisor's minimum objective quality specifications (this is consistent with most U.S. franchise agreements);

(b) To require the franchisee to purchase goods manufactured by the franchisor or by third parties where quality specifications are not possible due to the nature of the goods (this is consistent with most U.S. franchise agreements);

(c) To allow in-term and post-term (up to one year after termination) non-competition clauses protecting the franchisor and any other franchisee but only within the exclusive territory (this is more restrictive than under most U.S. state laws and franchise agreements);

(d) To prohibit the franchisee from acquiring a financial interest in a competitor which would give the franchisee the power to influence the economic conduct of the franchisor (this is more liberal than most U.S. franchise agreements);

(e) To require the franchisee to sell the goods only to end users, to other franchisees and to resellers within other channels of distribution supplied by the manufacturer or with its consent (this is more liberal than most U.S. franchise agreements);

(f) To require the franchisee to use best efforts to sell the goods or provide the services which are subject to the franchise (this is consistent with most U.S. franchise agreements);

(g) To require the franchisee to offer for sale a minimum range of goods, achieve a minimum turnover, plan its orders in advance, keep minimum stocks and provide customer and warranty services (this is consistent with many U.S. franchise agreements); and

(h) To require the franchisee to pay to the franchisor a specified proportion of its revenue for advertising and engage in local advertising which is subject to the franchisor's prior approval (this is consistent with most U.S. franchise agreements).

5. **Unconditional Permitted Obligations.** In addition, the following unconditional permitted obligations of the franchisee can be imposed:

(a) The franchisee shall not disclose to third parties the know-how provided by the franchisor, including after the termination of the franchise agreement (this is consistent with most U.S. franchise agreements);

(b) The franchisee shall communicate the franchisor any experience gained in exploiting the franchise and to grant to the franchisor and the other franchisees a non-exclusive license for the know-how resulting from that experience. (This is different from U.S. practice whereby under most franchise agreements the franchisor becomes the sole owner of this information, not merely a non-exclusive licensee);

(c) The franchisee must inform the franchisor of infringements, license, industrial or intellectual property rights and take legal action against infringers or assist the franchisor in any legal actions against infringers (this is consistent with most U.S. franchise agreements);

(d) The franchisee shall only use the know-how licensed under the agreement pursuant to the franchise agreement and not use it after termination of the franchise agreement (this is consistent with most U.S. franchise agreements);

(e) The franchisee shall attend or have its staff attend training courses arranged by the franchisor (this is consistent with most U.S. franchise agreements);

(f) The franchisee shall apply the commercial methods devised by the franchisor, including any subsequent modification thereof, and use the license, industrial and intellectual property rights (this is consistent with most U.S. franchise agreements);

(g) The franchisee shall comply with the franchisor's standard for the equipment and the premises and/or means of transport (this is consistent with most U.S. franchise agreements);

(h) The franchisee shall allow the franchisor to inspect the premises and/or means of transport, including the goods sold and the services provided and the inventory and accounts of the franchisee (this is consistent with most U.S. franchise agreements);

(i) The franchisee shall not relocate the franchised premises without the franchisor's prior consent (this is consistent with most U.S. franchise agreements); and

(j) The franchisee shall not assign the rights or obligations under the franchise agreement without the franchisor's consent (this is consistent with most U.S. franchise agreements).

6. **Compulsory Provisions.** Under Article 4, the following provisions must be contained in any franchise agreement in order for the Franchising Block Exemption to apply:

(a) The franchisee must be free to obtain its goods from other franchisees or other authorized distributors (this is more liberal than provided in most U.S. franchise agreements).

(b) Where the franchisor obligates the franchisee to honor guarantees, the guarantee obligation shall apply as to any goods supplied by any member of the franchise network or other distributors which give similar guarantees in the Common Market (this is consistent with most U.S. franchise agreements); and

(c) The franchisee must indicate its status as an independent contractor, but this should not interfere with the trademark signage (this is consistent with most U.S. franchise agreements).

7. **Prohibited Provisions.** Article 5 prohibits the inclusion of any of the following provisions; otherwise, the Franchise Block Exemption is not available:

(a) Agreements between competing manufacturers/suppliers of identical or similar goods or services (this is similar to the prohibitions under U.S. antitrust laws);

(b) Prohibiting the franchisee from obtaining supplies or goods of a quality equivalent to those offered by the franchisor, subject to the franchisor's right to approve suppliers (this is similar to U.S. anti-tying restrictions);

(c) A franchisor refusing to designate as an approved supplier, a supplier proposed by the franchisee if such refusal is for reasons other than protecting the franchisor's industrial or intellectual property rights, or maintaining the common identity and reputation of the franchise network (this is similar to U.S. anti-tying restrictions);

(d) Prohibiting the franchisee from continuing to use the license know-how after termination of the franchise agreement where the know-how has become generally known or easily accessible other than by breach of an obligation by the franchisee (this is fairly consistent with U.S. state trade secret laws);

(e) A prohibition against the franchisee from setting its own prices. The franchisor cannot set either minimum or maximum prices although the franchisor can recommend prices. (This is similar to U.S. antitrust laws);

(f) Prohibiting the franchisee from contesting the validity of the franchisor's industrial or intellectual property rights (this is a common prohibition in U.S. franchise agreements); and

(g) Restricting a franchisee's ability to sell goods or provide services to end users because of their place of residence (this is similar to U.S. antitrust laws).

8. **<u>Opposition Procedure</u>.** Under Article 6, any agreement that fulfills the conditions of Article 4 can take advantage of the Franchising Block Exemption even thought it contains restrictions on competition which are not covered by Articles 2 and 3 but do not come within Article 5 (*e.g.*, a refurbishment provision) provided the agreements in question are notified to the Commission in accordance with Commission Regulation Number 27 and the Commission does not oppose such exemption within a period of six months from such notification.

9. **<u>Withdraw of Exemption</u>.** Under Article 8, the Commission can withdraw the benefit of the Franchising Block Exemption if an agreement, although in compliance with the Franchising Block Exemption, nevertheless has certain effects which are incompatible with Article 85(3), and in particular where territorial protection is awarded to the franchisee; and

(a) Access to the relevant market or competition is significantly restricted by the cumulative effect of parallel networks of similar agreements established by competing manufacturers or distributors;

(b) The goods or services do not face, in a substantial part of the Common Market, effective competition from goods or services which are identical or considered by users as equivalent in view of their characteristics, price and intended use;

(c) The parties, or one of them, prevent end-users from obtaining, directly or indirectly, the goods or services because of their place of residence;

(d) Franchisees engage in price fixing; or

(e) The franchisor uses its inspection right, its right to restrict relocation or to consent to the transfer of the franchise agreement for reasons other than protecting its trademarks.

IV. <u>Competition Laws of Member Countries</u>

A. The Section of Antitrust Law of the American Bar Association has recently published the second edition of the <u>Survey of Foreign Laws and Regulations Affecting International Franchising</u>. The second edition (1990) updates the first edition published in 1982 and includes several more countries. Most of the EEC member countries as well as the antitrust laws of the EEC are included in the survey.

1. **<u>Belgium</u>.**

(a) The Belgium government maintains a very positive attitude towards foreign investment.

(b) The Belgium government is neutral towards franchising.

(c) Bills concerning the regulation of franchise agreements have been introduced in Parliament, but these bills have not resulted in the promulgation of a franchise law.

(d) There is no legislation, current or proposed, that would require foreign franchisors to register with or seek the approval of any ministry or agency prior to selling a franchise.

2. **<u>Denmark</u>.**

(a) The attitude of the Danish government and legislature toward foreign investment has traditionally been benevolent.

(b) The government has a neutral attitude towards franchising as it is a new, developing business concept in Denmark.

(c) There is no legislation or act that is pending particularly focused on franchising.

(d) There is no law requiring the registration of a franchise in Denmark.

3. **<u>France</u>.**

(a) The attitude of French authorities toward foreign investments has been to establish a system of authorizations and declarations for foreign investments in France, such as loans, guarantees, shareholding in French companies, purchase of real estate, etc.

(b) There is no specific attitude of the French government with respect to franchising in general, or the entry of foreign franchising in France.

(c) Draft regulations under a proposed French Franchise Disclosure Law were promulgated by the French Minister of Commerce late last year. The regulations have yet to be enacted.

4. **<u>Germany</u>.**

(a) The attitude of the Federal Republic of Germany towards direct foreign investment has been to treat foreign investors on the basis of equality of domestic investors.

(b) The German Franchise Association in Munich is a useful source of information for franchising in Germany. It may now be said that the general attitude is very positive.

(c) No legislation is in existence in Germany that specifically refers or defines franchising.

(d) The unification of Germany has not altered the current situation.

5. **<u>Italy</u>.**

(a) While there is no legislation which would particularly favor foreign over domestic investment in Italy, a persistently high level of chronic unemployment makes Italy very favorably inclined towards foreign investment.

(b) There is no particular attitude of the government with respect to franchising, domestic or foreign.

(c) There is no franchise legislation being introduced in the Italian Parliament and none is expected in the foreseeable future.

6. **<u>The Netherlands</u>.**

(a) The attitude of the Netherlands government is traditionally favorable towards foreign investment.

(b) The attitude of the Netherlands government is favorable towards franchising in general. Foreign and national franchising are equally favored. American experience in franchising is welcome.

(c) The Netherlands have not adopted any legislation specifically concerning franchising. Official policy is not directed specifically at franchising, but is generally favorable.

(d) No legislation concerning franchising is pending.

7. **<u>Spain</u>.**

(a) The Spanish government favors the increase of foreign investment in the domestic economy.

(b) Although the concept of franchising is comparatively new in Spain, official agencies have a positive attitude towards it.

(c) Franchising is not regulated in Spanish legislation. There is no legislation specifically referring to franchising.

8. **<u>United Kingdom</u>.**

(a) The government encourages foreign investment, particularly in manufacturing and where it involves activities with potential for significant employment generation. The government recognizes that franchising offers considerable potential for business formation and job and wealth creation in the U.K.

(b) The only U.K. legislation which may particularly focus on franchising is the Fair Trading Act of 1973. Part IX is devoted to pyramid selling schemes and could affect the structure of a franchise where it is intended to submit sub-franchise agreements.

(c) The Restrictive Trade Practices Act of 1976 may apply if an exclusive territory is granted to a franchisee, otherwise, franchise agreements do not have to be registered with the Office of Fair Trading.

(d) The U.K. government announced in late 1988 that a review is being conducted of its legislation, and it is possible that some changes may be introduced.

B. **IT IS ALWAYS ADVISABLE WHEN COMMENCING FRANCHISE ACTIVITIES IN ANY FOREIGN COUNTRY TO RETAIN U.S. COUNSEL EXPERIENCED IN INTERNATIONAL FRANCHISING AS WELL AS RETAIN LOCAL FOREIGN COUNSEL TO ASSIST IN STRUCTURING THE FRANCHISE RELATIONSHIP AND REVIEW AND APPROVE ALL APPLICABLE AGREEMENTS.**

V. International Franchising Models

A. **Methods of Expansion.** There are a number of ways by which a U.S. franchisor can expand into Europe. These include:

1. The opening of company-owned and operated units;
2. Direct franchising;
3. A branch or subsidiary operation;
4. Master franchise agreement; or
5. Joint venture.

B. **Expansion Factors.** The best format depends on a number of factors, including:

1. Existing management resources of the franchisor;
2. Capital resources of the franchisor;
3. Foreign investment restrictions and/or tax incentives;
4. Currency restrictions;
5. Foreign exchange and foreign trade restrictions;
6. Tax treaties and taxation;
7. Industrial and intellectual property laws;
8. Corporate laws;

9. Import/export controls;

10. Excise taxes and duties; and

11. Political and economic stability issues.

Time and the scope of this outline prevents delving into all of these issues. Nevertheless, each of these issues must be examined at the time that expansion is contemplated to determine the best approach. As previously indicated, since 88.2% of franchises sold outside the United States are sold directly or through master franchise agreements, we will concentrate on international master franchising agreements.

C. **International Master Franchising.** An international master franchise agreement is similar to the sub-franchisor concept used in the United States. The U.S. Franchisor grants to the Master Franchisee an exclusive territory (*e.g.*, country) and the Master Franchisee is responsible for selling and servicing Foreign Unit Franchises within the exclusive territory.

D. **Basic Structure of International Master Franchise (all subject to negotiation).**

1. The Master Franchisee is granted an exclusive territory (*e.g.*, country) and must develop a prescribed number of franchises pursuant to a schedule of development contained in the International Master Franchise Agreement. The Master Franchisee may or may not be granted the right to open its own units.

2. The U.S. Franchisor gives to the Master Franchisee rights to the tradename and other proprietary marks, the business format, loan of the manuals, initial training (train-the-trainer) and other assistance.

3. The Master Franchisee usually pays an up-front master franchise fee to the U.S. Franchisor for the International Master Franchise Agreement.

4. The Master Franchisee signs the franchise agreement with the Foreign Unit Franchisee (the U.S. Franchisor is not a party). The Master Franchisee assumes all sales and servicing functions, including training and on-going support of the Foreign Unit Franchisee.

5. The Master Franchisee receives all initial franchise fees and royalties from the Foreign Unit Franchisees and remits a portion of each (*e.g.*, 1/3) to the U.S. Franchisor.

E. **Reasons why a U.S. Franchisor would want an International Master Franchisee instead of opening company-owned units or direct franchising:**

1. Rapid expansion;

2. Greater resources;

3. Reduced staff;

4. Sharing of risk;

5. Access to other ideas;

6. Local presence and knowledge;

7. Greater incentive for Master Franchisee to sell and service franchises;

8. Foreign investment restrictions; and

9. Alleviate various tax and tariff problems.

F. **<u>Disadvantages to International Master Franchise Relationship</u>:**

1. Loss of control;

2. Loss of revenue;

3. Increased risk of vicarious liability;

4. Difficulties in enforcement; and

5. Concessions required by Master Franchisee.

G. **<u>Key Issues in Structuring an International Franchise Agreement</u>.** In negotiating and drafting an International Master Franchise Agreement, the following key issues should be addressed:

1. Description of the right to be granted by the U.S. Franchisor to the Master Franchisee, including the proprietary marks, know-how, confidential information, manuals, right to franchise, etc.

2. The master franchise territory;

3. Exclusivity;

4. Initial Term and Renewal Term;

5. Duties of the U.S. Franchisor;

6. Master franchise fee, sharing of initial franchise fee and royalties and other fees such as renewal fee and transfer fee (including type and method of payment, risk of currency fluctuations, exchange controls and inflationary safeguards);

7. Withholding of taxes and gross up provisions;

8. Duties of the Master Franchisee;

9. Schedule of Development;

10. Proprietary Marks;

11. Confidential Manuals and Confidential Information;

12. Accounting and Records;

13. Transfer of Interest (assets or stock);

14. Default and Termination;

15. Obligations Upon Termination;

16. Independent Contractor and Indemnification;

17. Representations and Warranties; and

18. Choice of Law and Venue.

VI. **The Future of Franchising in Europe**

A. The Single European Act will eliminate fully the internal barriers within the EEC by 1992. These barriers relate to physical barriers, such as the movement of people and goods, technical barriers, such as product specifications and professional qualifications and fiscal barriers such as the harmonization of tax rates and a common currency. For the post-1992 Single European Market, franchising may be one of the best marketing formats to take advantage of the removal of these barriers.

B. The Franchising Block Exemption does result in some certainty in developing franchise agreements and franchise systems. Consideration must be given as the target member country's competition and special franchising laws and local laws which could impact upon franchising and franchise operations.

C. While certain barriers will be removed and greater legal certainty exists, there will still be the need for adapting the franchise system on a country-by-country basis to address language differences, cultural and lifestyle differences, individual tastes and habits and national characteristics. Therefore, a local presence is always advisable. Consequently, international master franchising will continue to be the most desirable expansion format, particularly for smaller U.S. franchisors.

D. With expectations within the United States that by the year 2000 nearly 50% (over $1 trillion) of retail sales will be accomplished through franchised outlets, and as more and more different types of goods and services are being sold or rendered through franchised outlets, it is inevitable that Europe will experience a similar, proportional growth in franchising. The Block Franchising Exemption and the changes in 1992 will only help accelerate this growth.

E. The great changes being experienced in Eastern Europe during the last few years are further intensifying U.S. interest.

F. Five hundred years after Columbus discovered America, perhaps Columbo Yogurt or some other U.S. Franchisor will discover Europe.

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