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Global Expansion in a Stay at Home World: How Franchise Systems Expand Internationally Today

Maral Kilejian
Partner, Haynes & Boones LLP
Houston, Texas, U.S.

Craig Prusher
Executive Vice President, CLO, Church's Chicken
Atlanta, Georgia, U.S.

Larry Weinberg
Partner, Cassels Brock LLP
Toronto, Canada

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IFA 54TH ANNUAL LEGAL SYMPOSIUM

GLOBAL EXPANSION IN A STAY AT HOME WORLD: HOW FRANCHISE SYSTEMS EXPAND INTERNATIONALLY TODAY

A. INTRODUCTION[1]

So, you or your clients are interested in expanding a franchise system internationally. “Global Expansion in a Stay at Home World: How Franchise Systems Expand Internationally Today” is a first-time workshop at the International Franchise Association’s (“IFA”) Legal Symposium. The authors’ mandate from the IFA is to prepare a paper on the topic of international franchise expansion in today’s trying global environment of a worldwide pandemic. The age of COVID-19 has ushered in a plethora of novel legal and business considerations for franchisors hoping to expand internationally; however, the fundamentals of international expansion remain largely unchanged. As such, we borrow many of the foundational topics, ideas and concepts discussed in the paper “Basics Track: International Expansion” prepared by Francesca Turitto, Donald P. Wray Jr., Tao Xu and, our very own, Larry Weinberg (with assistance from Ashley King). That paper was presented at a workshop by the same name at the 52nd Annual Legal Symposium in 2019. We want to express our gratitude to those authors.

B. ASSESSING READINESS IN UNPRECEDENTED TIMES: ARE YOU READY TO EXPAND INTERNATIONALLY?

A global pandemic is raging. International travel is at a standstill. The world’s largest economies face the real risk of a prolonged downturn. Is now the right time to expand your franchise internationally? Don’t get us wrong – the answer could be yes, but a strategic assessment of your readiness is more integral than ever.

Even at the best of times, it can be a daunting task for a franchisor to ensure it has the ability to replicate the most salient components of its domestic system in a new market, all the while navigating the legal, conceptual, cultural, supply chain, and economic differences of one or more international markets. And if that’s not arduous enough, you can now add varying public-health regulations to the mix.

Experience tells us that, far too frequently, the neophyte franchisor approaches international expansion reactively. An unsolicited offer for their franchise rights is received from a far-off place. The allure and excitement of “making it” as a global franchisor (not to mention the promise a handsome initial fee) gets the best of them, and, knowing little about the country and even less about the potential franchisee, they rush into a business endeavor ill-prepared.

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[1] The authors would like to thank Zachary Zittell, articling student at Cassels in Toronto, Canada, for his significant assistance with preparing this paper.

Avoiding falling into the “neophyte trap” is now more critical than ever given the unprecedented circumstances facing virtually every international market. Global pandemic or not, the responsible franchisor takes a strategic and proactive approach to international expansion. Preparation is paramount. They will target specific countries or regions only after careful analysis and planning. They will select a franchisee with great care after significant research and vetting. And they will establish a strategy to ensure “success on the ground”, from training key personnel to supply chain management.

Obviously, today’s state of affairs makes this planning more important—and more difficult—than ever. The crucial first step for any franchisor considering an international expansion is assessing their readiness. The following factors can help determine whether your system is indeed ready to go global during these unprecedented times:

1. Does it fit the corporate goals?

An international expansion may have been a good idea 15 months ago, but given all that has changed, a franchisor should take a long, hard look at its system to ensure it can sufficiently answer the most basic of questions: “Why?” and “Why Now?”.

Wanting to bear the title of “international brand” is not enough to justify expansion. The decision must align with the corporate goals of the franchise system, and its ownership. Critically, a responsible franchisor must determine if and how these goals have been impacted by the pandemic.

The following questions are a good starting point to consider before committing to expand internationally:

- Has the pandemic impacted our short-term and/or long-term strategy?
- Is international expansion now an appropriate strategy to spread the business risk across a number of markets?
- Will the international initiative cause us to lose focus on our domestic market recovery and growth – or can we realistically tackle both at the same time?
- Does the international initiative have the potential to be more profitable than further domestic expansion?
- Will we be able to provide adequate levels of support to our international franchisees using internal resources?
- Are we “going international” as a part of a well-thought-out long-term plan for the company?
- Are there external factors (competitive actions, developments in international markets, opportunities to partner with significant international players, etc.) that we should allow to influence the decision to go international now rather than later?

- Are there other benefits associated with going international that make this a short-term priority?

2. Does the franchisor have the resources available?

Setting up a franchise internationally is not cheap. Even before the pandemic, with the franchisor bearing some or all of the cost of intellectual property protection work, market research, travel fees, due diligence, contract drafting and marketing costs, the upfront investment of an international expansion can quickly exceed U.S.$100,000.

The question is: how does COVID-19 impact these costs, and the general availability of resources needed by a franchisor to expand internationally? If travelling to the desired market is not an option, you may be able to save a few dollars on airfare. Conversely, perhaps you will need to hire an on-the-ground confidant to facilitate the expansion. Even if your on-the-ground confidant is "in country", can they freely travel around within the country to do the job? Can some or more of these costs be downloaded to the potential international franchisee candidate? Those headed overseas need to be prepared for the costs of doing business internationally—many of which could be unforeseen—before making that commitment.

3. Does the franchisor have the right people?

Capital isn't the only resource necessary for a successful international expansion. A new international franchisor will need to have the people to provide service and support to their new international franchisees. This consideration rings true irrespective of the pandemic.

There is often an initial inclination for franchisors to say that their domestic team can handle an international expansion, but, even in the best of times, this approach is not without its risks. First is the possibility of resource cannibalization. If personnel are reassigned from their domestic duties to tend to new international needs, the former could go neglected to the detriment of the system. Second, the domestic team may not be well suited to tend to the tasks necessary to complete an international expansion. While pandemic travel restriction may in-fact ease the burden on your domestic workforce with respect to the travel requirements that would have otherwise been necessary, a great deal of time and energy will nevertheless need to be expended in order to execute a successful expansion.

Assessing the readiness of a domestic system requires a franchisor to conduct a roll call and honestly assess any gaps that may exist in their human resource capabilities. From the legal and marketing teams to IT and operations, each area's current capabilities must be considered, as well as what it would take to realistically extend—and, ultimately, replicate—core skills and processes within an international franchise network. Diversity of expertise, adequate bandwidth, and synergy among the domestic team will increase the likelihood of a smoother transition during the expansion process. Nevertheless, remembering that a successful domestic team does not necessarily translate to a successful international team cannot be overstated.

At the present time, the domestic team cannot likely travel to any potential international market now or for the foreseeable future. It has always been the case that local "on the ground" assistance of some kind is generally necessary to assist in a new franchisee's launch. If the travel restrictions arising from the pandemic remain in place as between countries (including quarantine requirements upon arrival in certain countries), can the franchisor find trustworthy local resources to assist in providing these services? In this new stay at home world, that is an option to be considered more than ever before.

4. Competitive Landscape?

Competition in international markets for U.S. franchisors has greatly increased over the past three-decades. The decision to expand globally should take into consideration whether a franchise system is prepared to compete with local brands and international franchise giants who may already have footing in the desired market.

It goes without saying that the pandemic has left its mark across every industry and in virtually every country. It continues to be the case that many brands enjoy a reputation far beyond the borders of their own country, and so demand for these brands often exists in many pockets of the world. The pandemic may not have dampened that reason to expand; perhaps it has changed the local landscape to make it even more attractive. It is crucial to understand the new current conditions of the desired market. In some cases, an opportunity may present itself in a market where competition has gone out of business and the cost of borrowing is low.

It is equally important to consider the competitive landscape with respect to attracting prospective franchisees. As a new entrant, you will need to compete within the same pool of franchise prospects as existing systems in the market. Generally, existing systems will have an advantage here, especially those that are native to that market, given their better knowledge of local language, customs and culture, and established access to resources, real estate and supply chains. Again, the impacts of the pandemic may come into play. Perhaps higher unemployment has increased the pool of individuals looking to acquire franchise rights. Businesses that have gone under may have assets ripe for acquisition at a discount. These considerations must be made thoughtfully and with an acute appreciation for the circumstances facing the specific market the franchisor hopes to expand to.

5. Supply Chain?

This consideration really cannot be overstated. It is incredibly important that a franchisor researches and understands the local supply chain required for the local franchisee's success. Holes in a supply chain quickly lead to product shortages, which lead to an inability to provide services, and ultimately, a failed business. Less obviously, given the distance between your home market and the foreign franchisee, issues with a supply chain may not become known until it is too late. In the interim, the franchisee may attempt to create a workaround solution with unapproved or lower quality alternatives. And given your inability to visit the market with the same level of frequency as you did prior to the pandemic, how long will the workaround situation continue before you uncover it? Perhaps you avoid a failed business, but a damaged brand can have serious repercussions not only locally, but across your entire system.

Doing the research and ultimately making the right logistic choices is of critical importance. A responsible franchisor will endeavor to work closely with local partners before contracts are signed to ensure the necessary products can be sourced and delivered. Suppliers should be preapproved and contingencies should be put in place. Read that last one again. Contingencies should be put in place. If the pandemic has taught us anything, it's that you cannot simply rely on a *force majeure* clause to get you out of trouble. Think carefully about what could happen if imports are restricted, or your existing suppliers go under.

When drafting contracts with local franchisees, key points with respect to supply chain include: (i) the franchisor's retention of a contractual approval right over new suppliers or new products/services offered by the local franchisee to ensure compliance with franchisor's standards throughout the relationship together with (ii) clear limitations on the franchisee's ability to source products from unapproved suppliers if and when approved suppliers become unavailable.

C. CONSIDERATIONS FOR MARKET PRIORITIZATION DURING A PANDEMIC

A focused approach to international expansion is integral to success. In "normal" times, a responsible franchisor must assess a litany of issues before selecting an international market for expansion. Inevitably, the choice of market will often dictate strategy. Should you focus on a market with a large middle-class where franchising is well accepted? Or perhaps a market with a barbell distribution of wealth? Are you better off in a large market with greater competition, or a smaller market where competition is less developed?

The year 2020—and the pandemic that came with it—ushered in a fresh wave of factors that not only warrant serious consideration, but will likely act as threshold issues in the identification process of prospective markets for years to come. How is the restaurant industry fairing? Are gyms even open and operating at this time? Are there noteworthy public-health regulations? Can you travel to the desired market? What is the state of the economy? How has unemployment been affected? Are the changes in the market permanent or are they temporary? Is your brand and business model flexible enough to adapt to the changes or are you stuck trying to grow an old-world business in a very new world?

Answering these questions will not only allow a franchisor to responsibly prioritize which markets to expand into, but will also assist the franchisor in selecting the appropriate franchise structure for said expansion. More on this below.

1. Market Knowledge

The responsible, proactive franchisor will endeavor to gain a complete understanding about a potential market prior to pursuing an expansion. Part of that understanding involves appreciating the franchise "climate" in a particular country (e.g., licensee's ability to sub-franchise, recognition by the legal system, the general feelings toward franchising, size of the middle class, degree to which other franchisors have been successful in the market, etc.).

(a) What the Pandemic Has Changed

(i) Power and Politics

COVID-19 has, and will continue to, impact various market forces that are critical to forecasting a franchisor’s success abroad. Politically, states of emergency have given extraordinary executive powers to democratically elected officials across the globe. World leaders are ruling by decree, elections are postponed, travel is restricted, businesses are shuttered, all the while protestors are flooding the streets. We do not offer any political commentary here, but simply wish to remind the franchisor looking to expand abroad to remain keenly aware of the ever-changing political climate in a given target market.

(ii) Economy

The only major economy to grow in 2020 was China. If you are considering an expansion into one of the other 194-some-odd countries in the world, you will be entering a stagnant or shrinking economy. The speed of vaccinations, so called “herd immunity”, and economic recovery will vary greatly between nations. Every country has its own approach to stimulus and understanding what your desired market is currently doing—and what it may begin doing in the near future—will be important for ensuring success at the onset of your expansion.

As in non-pandemic times, a franchisor must understand the variances in exchange rates and how this can impact royalty payments and costs of goods sold.

(iii) Public Health

While the nuances of a country’s public health regulations must be assessed (and will be discussed more specifically below), this section serves as a reminder that there can be significant discrepancies in the public health system of a given country compared to your home market. While the pandemic may come under control where you are, a foreign market may continue to face rising infection rates for years to come due to a disparity in resources or infrastructure. While this is a novel consideration for a franchisor, it is incredibly important in these times.

(b) Efficiency of Support for Franchisees

This is often a complex issue. Factors that will influence support needs and costs include the structure of the offer (area development, master franchise, or direct franchising), complexity of the business, the relative strength and resources of the franchisee, as well as factors such as language, legal differences, consumer differences, time zone differences, distance, and supply chain. A responsible franchisor will consider these factors when developing their business plan for an international expansion, and, importantly, identify roles and responsibilities for supporting the local franchisee.

(c) Socio-Cultural Differences

An appreciation of local language, customs, preferences and religious beliefs can make the transition into a foreign market much more seamless. These can impact dietary or alcohol restrictions, segregation of sexes, a need to plan around holidays or daily prayer times, mandated benefits or vacation, and even a need to import labor.

Therefore, a holistic understanding of local customs and expectations can help a franchisor modify its offering for an international audience. Foreseeable modifications might include altering certain product offerings to suit local tastes, altering the labor model, changing sources of supply, and adapting consumer marketing.

(d) Forecasting Potential Profitability

As with any new business proposition, a franchisor should develop a financial feasibility model that establishes the best path forward not just for themselves, but for their local franchisee as well.

The primary focus of this financial model should account for <u>differences</u> in the unit economics in the following areas:

- Development and real estate costs (land costs, key money, costs of construction, costs of equipment, differences in rent costs that would impact target locations, average rent costs for the target location, etc.).

- Consumer buying power and local competition (Are there enough consumers who can afford the product/service and if there are, will they be drawn to existing competitors that offer substitute products at substantially lower prices? How will that impact the franchisee's consumer pricing? How fragmented is the local market? If there are dominant players in the market, how will the franchisor differentiate itself from established brands?).

- Costs of goods sold (Are current or substitute products readily available through the local supply chain? At similar costs? Will tariffs be imposed on imported products? How will exchange rates affect costs? Are there any restrictions on imports? How will consumer pricing strategies impact cost of goods sold (COGS)?).

- Costs of labor (Is qualified labor readily available and at what cost? Do local customs or laws dictate different labor practices?).

A further important step for a franchisor is to compare the prices charged for "like products" in the target market in select competitive locations. This practice allows the franchisor to gain insight as to unit economics in the competitive environment.

(e) Legal Climate

Understanding the legal system of the target market is a worthwhile course of action for a franchisor. What legislation is currently impacting the local business environment? A franchisor must be aware of laws regarding the offering of franchises, anti-trust, tying, anti-competitive measures, protection of trademarks and intellectual property, enforceability of in-term and post-term noncompetition clauses, repatriation of profits, import restrictions, and taxation, just to name a few.

2. Franchisee Recruiting During a Pandemic

Arguably more important than almost any other factor is the selection of a qualified international franchisee. This is now more important than ever given the pandemic's impact on a franchisor's ability to meet with and visit prospective franchisees in person.

Identifying the desirable characteristics of such an individual is an important step in the preparation process. A franchisor must be able to outline some core competencies to help narrow down the franchisee pool and screen out those who lack the ability to succeed in this complex business relationship and in a time where remote management is the new normal.

(a) Qualifying Franchisees

Selecting the right franchisee in a target jurisdiction can make or break a successful international expansion. There is often an allure of partnering with an established area developer or master franchisee given their proven knowledge and experience in the market, however; there are potential downsides to this approach. Dictating fees (and sometimes refusing to pay initial fees entirely), mandating operating standards, and insisting on development strategies are but some of the uncomfortable challenges franchisors may face. And while they will likely be much more adept at concept adaptation, they will be equally likely to cut their losses quickly if a concept does not perform to expectations.

The calculus of selecting an appropriate franchisee is even more complex in the multi-dimensional context of a master franchise relationship. Obviously, a franchisor must look for an individual or a company that will be a solid custodian of the brand, a capable operator of the franchisor's concept in their own right, as well as an effective marketer of its own sub-franchises.

Given the impact of the pandemic on global travel, it is arguably more important than ever to properly vet and assess candidates before selecting a franchisee for an international expansion. The following factors should act as guiding considerations in the process of qualifying franchisees:

(i) Net Worth and Financial Strength

It is common for a franchisor to establish a net worth requirement as a threshold test for identifying prospective franchisees who are able to adequately fund the investment. This becomes even more important when dealing with international franchising. These “net worth parameters” will differ between markets, and should be based on local development costs, the availability of credit, and the number of locations that will be a part of the development plan for the franchisee. Of course, the desired franchise structure will also bear implications for what will be expected from any given franchisee.

(ii) Willingness to Champion the Brand

As with any team, “buy in” is an integral ingredient for success. A franchisee in a new market should share the company’s goals and values and feel a sense of ownership and pride for the brand. Only then can you trust that your franchisee will be fully committed to the business’s growth and long-term success. As systems flesh out what functional support looks like in what is often a brand new jurisdiction, the commitment of owner-operators who believe in the overall mission can be incredibly valuable.

(iii) Business Acumen

The “dream” for international franchisors is to find a franchisee in a foreign market that will be able to drive expansion and brand growth without substantially depleting the franchisor’s corporate resources. Finding a franchisee that has their own relationships or experience necessary for navigating the local business landscape can go a long way.

(iv) Sound Vision for Developing Concept in Target Jurisdiction

As a part of your vetting process, you should require each candidate to prepare a detailed business plan that discusses issues such as prototype development and adaptation, real estate and construction (if applicable), business economics, competition, staffing for support, and a plan for growth. The candidate should provide you with detailed pro forma P&L’s of the individual units as well as a consolidated P&L so you can confirm that the candidate has realistic expectations about how quickly they become profitable.

It is common for franchisors to provide candidates with a template or outline from which to work. Seriously considering a prospect’s proposal can provide insight into market conditions and the reasonableness of the individual’s expectations for growth and development. And, most importantly, it will provide a deeper understanding of the candidate’s commitment, thinking, and resources.

(v) Communication Skills

In the best of times, working with an individual in a different country can present inherent challenges with respect to time zone differences and language. It is important for a franchisor to evaluate the degree, clarity and regularity of communication they receive from candidates, as this can be indicative of their commitment to the project and will often set the tone for future interactions.

Also, franchisors should not be afraid to require some level of fluency in English as a prerequisite for prospective franchisees. This practice is widely accepted, and many notable international brands use English as their official corporate language.

(vi) Trust

If things go wrong, you must have feet on the ground that you know will do what needs to be done to remedy the problem. Trusting your franchisee is even more integral now that there are likely restrictions on your ability to move quickly to visit a location if the business experiences serious problems. This is hard to quantify but is nonetheless an important factor to consider when selecting a franchisee.

(b) Prospecting for International Leads

Creating the profile for an ideal candidate is only the first step. Next, thought must be given to how a franchisor will actually find these prospects. While unsolicited offers may be exciting, the best candidates are generally those that are targeted with a focused marketing effort.

Below is a list of some of the most common methods for identifying prospects. Importantly, the pandemic has impacted the viability and efficacy of some of these methods. This will be discussed below.

(i) International Franchise Brokers

One of the simplest methods for identifying franchisee candidates in a foreign market is to employ a specialized broker. These brokers may have a global reach or are perhaps confined to a specific regional market. Often, the broker will require a franchisor to initiate the process with a market study. The franchisor will then be responsible for paying for local advertising (directed by the broker), monthly fees, travel expenses, and success fees (which may run 20% or more of the initial license fee for the country). While a broker can simplify the process, it can also be quite costly.

The pandemic may make the use of an international franchise broker an even more attractive option. A franchisor may have little other practical option but to rely on the broker's expertise and knowledge of the local market, ensuring a successful recruitment that does not require an onerous amount of active supervision.

(ii) Governmental Programs

Governmental programs such as the Gold Key Matching Service provide another highly directed means of identifying strong candidates. Specifically geared to U.S. companies, this service will identify prospects and match you with them. While historically this would involve travelling to the desired international market, the service now offers virtual introductions. The service is offered through the U.S. Commercial Service, and is priced extremely reasonably, however; the strength of their franchise expertise varies by market. More information on the program can be found at: https://legacy.export.gov/Gold-Key-Service.

(iii) Franchise Trade Missions

Organizations such as the International Franchise Association regularly sponsor trade missions to various markets to promote franchising. Historically, these missions would include no more than a dozen franchisors who would travel to several countries in a specific region over the course of a week or two. For a cost of about $10,000 plus travel, franchisors are given the opportunity to meet qualified candidates in each market.

Due to the pandemic, as of the date of this paper, there no scheduled missions through the IFA for 2021. While this will likely change as the virus runs its course, the notion of travelling to individual markets as a means of recruiting local franchisees will likely no longer be the most common approach moving forward. If 2020 has taught us anything it's that business can be conducted virtually. As such, we wouldn't be surprised if the next trade mission you attend takes place over Zoom, WebEx or MS Teams.

(iv) International Franchise Trade Shows

The same sentiment applies here. Until the start of the pandemic, trade shows offered a great open forum for franchised brands to present their concepts in front of an audience of potential buyers. Although it has yet to happen, we would not be surprised to start seeing virtual events popping up over the next 12 months. Virtual or not, franchisors should be aware that not all prospective franchisees who attend these shows are qualified to invest in a franchise.

(v) Foreign Franchise and Trade Associations

Franchise and trade associations within the target market are often willing to help franchisors assess the viability of their concept and make appropriate introductions. Once again, this "on the ground" knowledge can be helpful, especially given the travel restrictions currently in place. While these associations may serve as a resource for franchisee recruitment, they should not be the center of a franchise recruitment strategy.

(vi) Traditional Advertising and/or Public Relations Activities

Franchisors can also default to more traditional methods of lead generation, such as social media, digital advertising, print advertising in specialized publications, and public relations. While these methods tend to be somewhat inefficient, they can occasionally generate satisfactory results if they are focused on a highly-targeted candidate pool.

(vii) Franchisor's Domestic and Local Counsel

It is not uncommon for experienced legal counsel (either in the franchisor's home market or abroad) to be a valuable resource in facilitating contacts with some or all of the above. Alternatively, well connected counsel may be able to make direct introductions with prospective franchisees or local lawyers with whom they have previously worked.

3. Due Diligence on Foreign Franchisees During a Pandemic

Conducting thorough due diligence before putting pen to paper with a prospective franchisee is imperative. Undoing a foreign transaction—or worse yet, being stuck with the wrong franchisee—can cost you and your system's brand dearly. The pandemic should not change the degree to which you conduct your due diligence, but it may change the means.

(a) Financial Qualifications

You should not just take a candidate's word that they are adequately capitalized. A diligent franchisor will investigate their prospect's financials independently, making use of whatever is available to them, including audit records, credit reports and bank statements. Forward thinking franchisors will also ask for Letters of Credit for a prospective franchisee in order to have reputable evidence of their financial standing.

(b) References, Background and Credit Checks

As you would do with any job applicant, it is important to conduct background checks and obtain references from prospective franchisees. The U.S. Commercial Service and a variety of private resources (i.e. Kroll) can help with these checks in a variety of countries. A franchisor may also consider compiling a detailed questionnaire that seeks to elicit a prospective franchisee's finances, reputation, litigation and/or bankruptcy history, criminal records, third-party business and/or government affiliations, professional licenses and even driving records. The franchisor should also contact the franchisee's references (including former or existing business partners, franchisors and/or vendors). Finally, reviewing social media profiles and traditional media articles can provide insight into the candidate's personal and professional image. If the candidate is an established company, there is often more information available from public sources.

(c) In-Person Meetings

Up until last year we would have told you that it is imperative to meet with your candidate and their team in person. We would have said that nothing beats meeting someone face-to-face to assess someone's capabilities and commitment to the brand. While this sentiment is not wrong, the last 15-months have shown us that sometimes this is just not a possibility. Previously, if a candidate was not willing to visit a franchisor's headquarters, it could be interpreted as to mean they lack the necessary commitment to a brand. Conversely, if a franchisor was not willing to visit a candidate in their local market, we would have suggested that this franchisor should question its own commitment to the expansion. Now, doing things virtually is the new normal and things may not go back to "the good old days" so fast (nor should they, necessarily). Other indications of commitment will need to be assessed, and at the end of the day, a franchisor may need to rely more heavily on references and first-impressions over virtual mediums to make these assessments.

(d) Virtual Meetings

We've been conducting business virtually for over a year now. It is undoubtedly more difficult to get a good read on a candidate over video, however; by asking the right questions and setting the right tone, you should be able to elicit helpful information that will sufficiently allow you to identify quality prospects. Some helpful tips and best practices are as follows:

- Set the tone: body language, background, eye contact and lighting can help set a professional and welcoming tone for a virtual interview. Set the bar to match the expectations you have for the candidate.

- Be understanding: while it is important to assess the prospect's professional etiquette virtually, you should be forgiving for technical errors or hiccups.

- Explore alternatives: with virtual meetings, there's an inclination to simply revert to a basic conversation. Question. Answer. Question. Answer. While this may work for some, don't be afraid to use more engaging alternatives, such as virtual whiteboarding. Getting a glimpse of a candidate's personality can help assess their "fit" within your system.

- Save for later: one benefit of conducting an interview virtually is the ability to record it and review it later.

(e) Validating Ownership Structures

A franchisor's home country's laws should be carefully assessed to ensure that the franchisor is legally permitted to conduct business with both the candidate and their personnel. For instance, in the U.S., under the "USA Patriot" Act, 115 Stat. 272 (2001), franchisors must thoroughly validate and assess each stakeholder to ensure that they are not on any prohibited parties lists. The U.S. Department of the Treasury and Department of Commerce both publish lists that designate individuals and companies "blocked from doing business with U.S. persons or entities". Other western countries have similar laws and restrictions.

D. STRUCTURAL MODELS FOR INTERNATIONAL DEVELOPMENT DURING A PANDEMIC

Assessing which franchise development model is appropriate for an international expansion is often franchise-specific. The decision, however, has a significant new variable that must be considered: the pandemic.

As a brief refresher, you can choose to expand internationally using any one of the following: an area development model; a master franchise model; a unit franchise model; an area representative model; or, combine one of the foregoing in a joint venture. While each has its own pros and cons, we are going to focus specifically on identifying which model, if any, is best suited for the post-COVID era.

1. Area Development Model

Under an area development model, a franchisor enters into an area development agreement with a third-party franchisee (often referred to as a “developer” or “area developer”) whereby the franchisee commits to develop and operate (either itself or through a controlled affiliated entity) a specified number of outlets within a defined territory. The pandemic’s impact on travel, real estate and the economic state of certain regions may make this model attractive on its face since it allows a franchisor to rely on a local franchisee’s knowledge of the target market. There is, however, a great deal of oversight required by a franchisor that can make this model less ideal during a pandemic. For example, the franchisor retains responsibility for providing the franchisor’s services under the area development agreement, which may need to include site approval, initial and ongoing training, and operational support and inspections. For obvious reasons, this can be difficult to accomplish if travel is restricted. While it’s always a possibility to delegate these responsibilities, liability will still fall at the feet of the franchisor if something is amiss.

2. Master Franchise Model

In a master franchise model, the franchisor grants a “master franchisee” the right to grant sublicenses to “subfranchisees” within a defined, usually exclusive, territory, and often, the right to open and operate franchised outlets within that territory. As with the area development model, a franchisor can rely on the local master franchisee for their knowledge of the target market. And almost by definition, a master franchisee is usually the most sophisticated type of franchisee, being chosen for the reason that they can fulfill the functions of a franchisor in the market/territory. That is a key element of a master franchise model—and what makes it arguably the most attractive model during a pandemic. And a part of that arrangement is that the franchisor has no direct contractual relationship with the subfranchisees, limiting the necessity to provide oversight or resources to support the franchise operations in the market. While it is common for the master franchisee to be obligated to develop and operate at least one outlet in the territory, this is a more manageable ask than being relied upon by an entire system in an international market, especially during a pandemic.

3. The Others

The trend in our analysis above suggests the less oversight required during the COVID era, the better. As with anything, there are two sides to every coin. There are undoubtedly benefits for certain franchisors to explore unit franchise or area representative models, and perhaps even a joint venture. The fact of the matter remains, it may be a long time until you can easily pick up and travel to and from a foreign market without impediment. Additionally, there is far more exposure to economic fluctuation when contracting directly with international franchisees. The contractual buffer of a master franchisee or an area developer will allow first-time franchisors looking to expand internationally to sleep a bit more soundly.

E. KEY BUSINESS ISSUES/NEGOTIATING THE DEAL

After selecting your local franchisee and determining your desired model, you are ready to negotiate your agreement. You will be pleased to know that many of the specific contractual terms for an international franchise agreement are quite similar to the terms negotiated domestically. But before getting into the minutia, it is important to be cognizant and sensitive to the cultural nuances and preferences of the party on the other side of the table (or screen). The influence of culture in contract negotiations cannot be overstated; doing your research prior to beginning the negotiation process can help ensure things go smoothly.

1. How a Pandemic Impacts Negotiations

While it remains true that many cultures favor in-person negotiations rather than speaking over the phone or email, the pandemic has obviously caused people everywhere to revisit these expectations. Most likely, your next negotiation may be conducted virtually. The "best practices" discussed above in Section C.3(d) apply and warrant review. Additionally, the realities of COVID-19 will likely play a role in determining a franchisor's stance on various contractual issues. In a pandemic-age, what's preferable: a large upfront fee or more substantial ongoing royalties? Perhaps you are less willing to terminate in the event of default given the difficulty associated with conducting this process remotely? The following are high-level business issues you will need to consider when negotiating your international franchising deal. The impacts of the pandemic (if applicable) will be discussed with each.

2. Fees

Except in very exceptional circumstances, the fees you generate from your international expansion are likely the reason you decided to expand in the first place. Sure, there are other business reasons (brand development, consumer recognition, etc.), but at the end of the day, the revenue you generate from these fees are the reason you are in business. Just as with domestic franchises, fees can be broken into a few categories, including: upfront initial franchise fees, unit initial franchise fees, advertising fees, and royalties. Given the focus of this paper, we won't conduct a detailed analysis into each, but rather discuss if and how the pandemic has impacted the levels appropriate in any of the categories and which should be considered more favorably as a result.

Perhaps the inevitable truth is that some international franchisee candidates will make attempts to use the pandemic itself as a justification for lower than usual fees. But the authors' views are that unless the pandemic has changed the franchisor's business model, and permanently altered the market for the franchise system's good and/or services, a franchisor should not now negotiate fees they would otherwise never negotiate.

But if there is to be a negotiation about fees, then a franchisor may feel justified in asking for larger upfront fees, so as to better act as a kind of security against a local franchisee’s default of royalty or other payment obligations (which may be more likely due to the economic uncertainty due to the pandemic).

Any franchisor now considering expansion should keep in mind that the short and even medium to long term ramifications of the pandemic are a lowering of costs. For instance, in major cities around the world, real estate costs for physical restaurant and retail storefronts are likely to be depressed for some time, which may create low cost opportunities for new franchise brands in a market.

3. Scope of Territory/Exclusivity

Determining the size of the market granted to your local franchisee involves a number of important considerations. These considerations are likely unchanged by the pandemic. A franchisee will likely negotiate for exclusivity throughout the country, perhaps suggesting that supply chain issues arise when additional groups are allowed to develop and that a single partner can streamline a franchisor’s administrative and support requirements in a foreign market. These are valid points, but a responsible franchisor will consider the risks associated with such an approach. The last thing you want is to be stuck with an exclusive franchisee who bit off more than they can chew. In the same way it’s advisable to diversify your investment portfolio, a wise franchisor may consider structuring a deal that permits the grant of licenses to additional local franchisees under certain conditions. A favored approach is what’s called a “staggered grant” of territory, where a local franchisee will be given growing exclusivity as they reach certain benchmarks. This approach may be favorable in a pandemic and post-pandemic times given the economic volatility that is likely to ensue for the foreseeable future.

4. Transfer Restrictions

Considering the difficulty described above with respect to vetting potential candidates, there is an argument to be made that during a pandemic, transfer restrictions should be made even more inflexible than is normally advised. To appease a franchisee who will often propose more lenient transfer rules, you may consider establishing a class of “permitted transferees”, who are pre-vetted or can easily be vetted virtually.

5. Termination Rights

Generally, you want to draft broad termination rights into an agreement. While this remains true in principal during a pandemic, it is important to understand the time and cost that can come with trying to enforce a termination or payment of monies in a foreign jurisdiction. It can always be complicated to terminate international multi-unit franchise rights, in part because of the reasons you chose to use area developers or master franchising; namely so that you do not have to operate directly in the target market. This is exacerbated because of the pandemic. It is now even less likely you will want—or successfully be able to—deal with the fallout of termination. For instance, even in countries with sophisticated judicial systems, civil proceedings are delayed months or years. The risk of entering a multi-year legal battle when trying to enforce a termination should make you consider offering various methods of curing events of default.

(a) Automatic Termination

There will always be reasons to include instances of automatic termination in a franchise agreement. For example, if the franchisee becomes insolvent, files a bankruptcy type of proceeding, or has an involuntary petition for bankruptcy filed against them, you will wish to have your agreement terminate automatically. It is important to remember that it is far easier to monitor your domestic franchisees than it is to do so with your international ones. As always, consult local counsel as provisions triggering automatic termination are not always enforceable in certain jurisdictions.

So, the more likely and important defaults that lead to automatic termination are often those that are seen as incapable of cure, namely breach of confidentiality or non-compete provisions, abandonment of the business, commitment or conviction of a crime, or a significant breach of local law.

As briefly discussed above, enforcing an automatic termination provision can be timely and costly at the best of times. Providing your franchisee with as many options to cure events of default (where possible, and within reason, of course) is advisable in today's environment.

(b) Termination on Notice

To echo the sentiments above, any termination on notice provision should afford the franchisee the opportunity to cure the default that triggers the notice. Obviously, certain breaches and actions cannot simply be cured (such as transfers without consent, breaches of confidentiality, etc.). But generally speaking, opportunities to "work with" your international franchisee are likely never more important than now.

Given the various public health restrictions in place around the world and the substantial penalties that can be associated with violations, it could be worthwhile considering adding a provision that deems the violation of local regulations for an extended period of time to be a triggering event.

(c) Default and Termination with a Right to Cure

As with all aspects of negotiation, it is important to consult with local counsel to ensure that the termination categories are enforceable. There are foreign jurisdictions—just as there are certain U.S. states—that only allow for termination with good cause, or require giving the franchisee an opportunity to cure.

In any event of termination, the franchisor should have the right to compel the franchisee to disassociate with all the system's IP including branding and signage. You also should expect the franchisee to (i) return any and all operating manuals, marketing materials and other documentation in connection with the operation of the franchise system; (ii) maintain the confidentiality of the franchisor's proprietary information and trade secrets; (iii) assign its ownership of any trademarks, web domains and other intellectual property to the franchisor and (iv) execute a termination agreement, preferably one that includes a release of all claims against the franchisor.

Note that in instances relating to enforcement, the appropriate remedy may be to seek a court or other similar order that the franchisee cease to operate, and comply with their post term obligations. However, in some countries, injunction like relief is very difficult and/or expensive to obtain, and in some places, it is not at all available.

When the agreement being terminated relates to master franchise rights, it has always been complicated to decide what rights and obligations, if any, the franchisor should have to “step into” by assuming the subfranchise agreements. That is perhaps even more complicated now, as a franchisor may have even less of an ability to assume the practical role of franchisor in the foreign market, by having the subfranchise agreements assigned to it.

It's always wise to keep the relationship with an outgoing local franchisee on as good of terms as possible. An amicable split can go a long way, especially in jurisdictions where both parties need to cooperate when it comes to the transfer of registrations or assets.

6. Noncompetition Covenant

A concern for any franchisor is how to prevent a franchisee from taking all the skills and knowledge you’ve shared with them and applying it to support or grow a rival brand. Pandemic or not, it is important to include strict noncompetition language in your agreement. In general, there are four key points to think about in the drafting of the noncompetition agreement: the definition of competing business, the scope of the limitation during the term of the agreement, the scope of the limitation post-termination, and penalties for breach.

(a) Defining “Competing Business”

The language you choose here will largely depend on the competitive landscape in the market you are entering. In an emerging market with limited competition, you can assume your franchisee is unlikely to be engaged in other business opportunities, and will be more willing to accept more restrictive language. In a more saturated market, a franchisee may have other business interests and push back on overly restrictive language. For this reason, having a deep knowledge of the market you are entering is incredibly important in order to draft an appropriate noncompetition covenant.

(b) Scope of Noncompetition during the Agreement

After defining “competing business”, you will need to establish what constitutes “restricted competition” during the term of the agreement and to whom it applies. Do you want to limit the restrictions to the individual/entity that is your franchisee? Should you include all owners and operators of the business? In addition to the group to which the noncompetition agreement applies, what sorts of activities will trigger your noncompetition restrictions? While it’s yet to be determined, markets may soon prove to be ripe for international expansion by North American franchises. If this is the case, it is imperative, more than ever, to ensure your franchisee is prohibited from devoting time and resources to the development of a competing brand. The scope of the restrictive covenants can vary widely – can your franchisee give advice to a friend looking to franchise with a competitor? If your franchisee has an interest in a financial institution, can that financial institution lend money to a competing franchisee? Ultimately, pandemic or not, the extent to which you limit competition will be dependent on the nature of your business and the franchisee, and negotiated terms.

(c) Scope of Post-Term Noncompetition

The scope of a post-term noncompetition provision will not be impacted but the realities of the pandemic. You must ensure that these terms are not overly burdensome; consulting with local counsel is important here as local law may very well override a contract on what is enforceable in the circumstances.

7. Development Schedule

Finding the right balance between an aggressive development strategy and a "slow and steady" approach is a bit of a Goldilocks endeavor. The pandemic has added a new consideration to an already interesting calculus: if you expand during the pandemic, should you try to move as quickly as possible to take advantage of what are perhaps attractive market conditions (cheaper real estate, lower costs of borrowing), or does the risk of ongoing lockdowns, restrictions and economic uncertainty lends itself to a slower approach?

The general words of advice are to aim for mutual success; if your franchisee succeeds, so do you. It has always been true, and now more than ever, that reasonable targets that are properly incentivized is a sure way forward. When considering means of incentivizing your franchisee, it is important to balance positive incentives (perhaps reduced royalties or fees for each unit that exceeds an agreed-upon development schedule) with disincentives or penalties for missing targets. If your brand is popular and desirable enough that replacing a lackluster franchisee is easy for you, you can consider making failure to meet targets an event of default. There are many variations of terms that can be implemented to incentivize your local franchisee and your expansion goals should be reflected in your selected methodology. Your counsel should be able to guide you to a good and legal solution that reflects the commercial realities of the local market.

And more than ever before, counsel should expect that force majeure provisions are going to be looked at with great care, and subject to important negotiations in light of the pandemic and its aftermath. Arguably, any development schedule should be tolled if the franchisee's territory suffers a shutdown of economic activity such as has been common in the pandemic era.

8. Other Points

(a) Taxes

Unchanged by the pandemic, the issue of tax treatment and responsibility will need to be addressed in your international franchise agreement. Understanding the local market's taxation rules is an integral step of your financial analysis. More specifically, issues such as whether (i) the target market has a tax treaty with the United States, (ii) a withholding tax is imposed on royalties in the target market (and if so, at what rate) and/or (iii) the target market imposes other quasi-taxes (such as a stamp tax), are likely to be featured in any such analysis.

(b) Supply Chain

See B.5, above, for a complete discussion on this important component.

(c) Impact of New Technologies on Key Terms

It can be difficult for franchisors to keep pace with the rapid innovation that takes place today, especially that which disrupts traditional business models. This is not going away – if anything, the economic rollercoaster that has resulted from the pandemic has already and may further result in a wave of new innovations and disruption. You must ensure your agreements are structured in such a way that you do not become restricted in your ability to implement changes that may be necessary in order to adapt and remain competitive. Be forward looking. You are well-advised to raise these considerations with your local and domestic counsel before a final agreement is delivered to your international franchisee. For instance, until recently who had ever heard of “ghost” or “dark” kitchens. And now they are seen as key to the survival of some restaurant brands.

F. FOREIGN FRANCHISE LAWS

Although the pandemic has impacted almost everything about our day-to-day lives, one thing remains the same: at home and abroad, we must remain compliant with applicable franchise legislation.

Over the last half-century, there has been a proliferation of franchise laws and regulations in countries around the world. At the very least, being aware of these laws gives the franchisor the opportunity to account for the increased costs of having to comply with disclosure and/or registration requirements when determining the initial franchise fees it wishes to charge the local franchisee. In some instances, franchisors looking to expand internationally may want to consider if a more suitable country to start is one without a franchise law, such as the U.K. Below is a chart that captures franchise disclosure and relationship laws (excluding civil code requirements) around the world as of the publication of this paper:

Country	Disclosure Laws	Relationship Laws
Albania	✓	✓
Angola		✓
Argentina	✓	✓
Australia	✓	✓
Azerbaijan	✓	✓
Belarus		✓
Belgium	✓	
Brazil	✓	

Country	Disclosure Laws	Relationship Laws
Canada (only in 6 of 10 provinces, namely Alberta, British Columbia, Manitoba, New Brunswick, Ontario, Prince Edward Island)	✓	✓
China	✓	✓
Estonia		✓
France	✓	
Georgia	✓	✓
Indonesia	✓	✓
Italy	✓	✓
Japan	✓	✓
Kazakhstan		✓
Kyrgyzstan		✓
Latvia	✓	✓
Lithuania		✓
Macau	✓	✓
Malaysia	✓	✓
Mexico	✓	✓
Moldova	✓	✓
Mongolia	✓	✓
Netherlands	✓	✓
Romania	✓	✓
Russia		✓
Saudi Arabia	✓	✓
South Africa	✓	✓
South Korea	✓	✓
Spain	✓	
Sweden	✓	
Taiwan	✓	
Tunisia	✓	✓
Turkmenistan	✓	✓
Ukraine		✓
Vietnam	✓	✓

In addition to the countries listed above, a responsible franchisor will be cognizant of jurisdictions with civil codes that may effectively impose disclosure requirements on franchisors (see, for example Austria, Germany and Quebec, Canada).

1. Disclosure Laws

If you come from a country with disclosure requirements, you have a head-start. While you may be able to use your U.S. franchise disclosure document in certain foreign jurisdictions with only minor modifications, other regions may require an entirely new document. Certain jurisdictions may regulate language requirements, format and timing of delivery, while others provide no guidance. As with most of the above, consulting with local counsel is imperative to ensure compliance. It goes without saying, but the cost of complying with a country's disclosure requirements that vastly differ from your domestic market's can be extremely high. This should be factored into any financial analysis regarding your expansion.

2. Registration Laws

Some jurisdictions require franchisors to submit franchise agreement for substantive review, translation and/or approval before the agreement can become effective. Consult with local counsel to confirm any requirements.

3. Relationship/Agency Laws

International relationship laws are generally similar to what can be found in the U.S., often requiring a franchisor to have good cause to terminate (with a cure period), or to refuse renewal or to transfer the franchise agreement.

A country's commercial agency laws may be applicable in certain nations where franchisees are considered independent contractors and fall outside the scope of labor laws. Agency laws generally protect franchisees from "unjust" termination, and can provide "extra-contractual indemnification to a franchisee in the event of termination, modification or non-renewal of the relationship by the franchisor without "just cause" (as defined under such laws), even when such termination, modification or non-renewal is done strictly in accordance with the terms of the agreement." The stringency and applicability of agency laws vary from jurisdiction to jurisdiction and can be fact-specific. As always, consult local counsel in the target territory to learn more.

G. TRADEMARK/INTELLECTUAL PROPERTY CONCERNS

Another component of international franchise expansion that is not impacted by the pandemic is a franchisor's responsibility to protect their intellectual property ("IP"). Under most franchise relationships, IP is the only asset that is actually shared, and as a result, fees and royalty payments almost exclusively relate back to the license of IP to the franchisee.

Every country has unique IP requirements and require independent registrations of trademarks and patents. Given the importance your IP plays to your brand's success (branding, trade-name, trade-secrets, etc.), it is important to be knowledgeable of the IP regime of your target market as you embark on your international expansion. Failure to prepare may result in a lapse in protection as you enter a new market which could diminish the value of your brand and undermine your fee structure.

1. Securing Your IP under Local Law

Obtaining patent protection outside of your home market requires planning and foresight. If you apply for protection in the U.S., you must file a Patent Cooperation Treaty application within one year of your filing just to have the ability to protect your patent internationally. Then, within 18 months, you must indicate to the World Intellectual Property Organization the countries you wish to nationalize the application for and pay national fees for each territory. If you fail to meet this timeline, you will be unable to secure protection of your patent rights, however; you can still license your technology and related know-how.

Trademarks and copyright also require a degree of planning, but not to the same extent. Every country's regime has its own timeline from application to registration, so it's always advisable to apply as soon as possible—sometimes before a local franchisee has even been secured.

While government bureaucracy was often a complicating factor in obtaining timely processing of a trademark application; the pandemic has only exacerbated this issue. In some countries, government agencies are closed or are dealing with a backlog. This can be an important issue in any potential deal, as a franchisor may have trouble convincing a franchise candidate that it should proceed if the franchisor cannot process or obtain their trademark registration in the market.

While there may be a temptation as a franchisor to off-load registration responsibilities to your franchisee, this can prove ruinous in the event of a market exit or transfer as the franchisor may be seriously dependent on the cooperation of the franchisee in the deregistration or transfer of the assets. Instead, a franchisor—as owner of the IP—should maintain direct responsibility for the process, and register its IP in the name of the franchisor (rather than the franchisee). Yes, this may be costlier, but it can save a lot of time, money and stress in the event of an untimely end to a relationship.

2. Granting License Rights to Your IP

There is an inherent risk when franchising abroad that a franchisor will be unable to sufficiently police misuse of its IP in the foreign market. Your franchise agreement should include clear language that details which IP is to be used, the ways in which it is to be used, and penalties for its misuse.

(a) Monitoring and Enforcement

As the owner of IP, you must be prepared to invest time and resources in monitoring infringement by third parties and maintaining registrations. Now, more than ever, it may be worthwhile to employ a third-party "watch service" to assist in the monitoring process given the restrictions on travel. Consider these costs when creating your franchise fee structure.

(b) Protecting the "Secret Sauce"

Compelling confidentiality from your franchisee from the first day your relationship is discussed through the last (and beyond), is central to protecting your brand. In most jurisdictions—as in the U.S.—your brand's "secret sauce" or "know-how" is not protectable under a formal registration regime. For this reason, the protection of this confidential knowledge lies in contract. In addition to a clear and unambiguous confidentiality provision, it is important to include an adequate noncompetition provision, as discussed above in E.6. This is a further means of ensuring your local franchisee cannot use the information you provide to the advancement of a competing brand. The scope of your noncompetition provision (such as to whom and for how long it applies), will require negotiations with your local partner and consultation with local counsel.

(c) Adapting to Cultural Differences

Over the last 20 years or so, it has been understood that many franchisors need to permit adaptation of their systems to local markets. Even the biggest, most well-known brands have recognized this necessity for success, which is sometimes driven by local customs and cultures, and sometimes as a matter of law. *Starbucks* is a classic example of how an international market's customs and cultural differences required an adaptation of existing IP. The semi-nude siren in their famous logo was unacceptable in Saudi Arabia, and they therefore adapted the mark to conform with the local laws. *Church's Chicken* could not realistically enter Indonesia, a majority Muslim country, using a brand name that was suggestive of Christianity, so the trade name and trademarks were changed to *Texas Chicken.* All this to say: be cognizant of local rules and sensitivities and be willing to adapt.

H. OTHER LOCAL LAWS

Even for the most experienced international brands, it can be difficult to keep track of local regulations as they adapt and change as result of the COVID-19 pandemic. From lockdowns and travel restriction to government subsidies and rent abatements, every country has a unique—and constantly changing—approach to dealing with the pandemic. For example, in Canada, many provinces halted the running of limitation periods at the onset of the pandemic. It is important to understand the nature and impact that any legislative amendments or changes may have on your franchise expansion efforts. Thankfully, our friends at Bird & Bird, based out of the U.K., have created the "Franchise COVID-19 Restart Tracker"—a country-by-country snapshot of local public health regulations around the world. The Restart Tracker can be found here: https://www.twobirds.com/en/in-focus/coronavirus-covid-19/international-franchise-post-covid-restart-tracker.

1. Quarantine and Public Health Regulations

Planning to visit your prospective franchisee in France? Be prepared for a 7-day isolation period before you see anyone. Want to visit Canada? Be ready for a 14-day quarantine that you are obliged to enter immediately upon arrival. Hoping to do a do an operations audit at your new franchised location in Venezuela? Not possible. There are over 160 countries that have at least some partial border closure and quarantine or self-isolation requirement. Additionally, many jurisdictions have public health regulations that mandate partitions in restaurants, frequent sanitization, capacity reduction, and other potentially capital-intensive upgrades to local establishments. In many cases, failure to comply can result in closure, large fines and even jail time.

These rules are ever-changing and require constant monitoring. Importantly, just because the pandemic may start to come under control in some parts of the world, most experts agree that the pandemic will exist globally for years to come. This understanding is largely what has driven the foregoing commentary in this paper. As you embark on an international expansion, be aware that the implications of the pandemic will be long lasting, and act accordingly.

2. Imports, Duties and Customs and Exchange Controls

The logistical feasibility of setting up a franchise system in a foreign jurisdiction—and the related costs—is largely dictated by the country's import and export laws. Regardless of the nature of your business, you must determine how to procure the products (both proprietary and otherwise) sold by the franchisee, as well as the required equipment, uniforms, signage and other branding components necessary for the operation of the franchise. To avoid import/export issues, franchisors may be able to find local sources for the goods and services franchisees need to establish their franchised business; however, this may prove difficult depending on the type of goods and services used in the franchise system and/or the current state of the local economy.

It is crucial to be aware of trade treaties (or lack thereof) between your home market and your desired expansion destination, especially if you will be relying on imports as a primary means of supplying your foreign franchisee. The cost of shipping goods, including associated duties, must be borne by someone, and these can have a significant impact on the viability of a franchise system in a foreign market.

At the outset of the pandemic, supply chains were disrupted, and, anecdotally, we heard reports of franchisors having to move quickly to make decisions on local sourcing where shipping was disrupted. In the long term, local sourcing may be the safest route.

In the restaurant industry, supply chains were severely impacted as the first wave of the pandemic saw an implosion of demand, and now (one year later) many in the restaurant industry who have always or now thrive with reliance on home delivery, takeout or pick up, have seen an explosion in their business. The reality is that until the pandemic, most of North America was behind the rest of the world when it came to dealing with these new delivery models, and the US and Canada had to quickly catch up.

3. Local Ownership Laws

Certain countries are very protective over their economic and political sovereignty and have enacted laws restricting foreign ownership in local businesses. China, Saudi Arabia and the UAE are examples of countries with such laws. These restrictions can vary widely, but generally include: (i) a requirement for the business to be established by a local citizen or entity, (ii) maximum foreign investment ownership thresholds, and (iii) restrictions on foreign ownership in certain industries which may be culturally sensitive. Ownership of IP, royalties payable and where items are sourced are other components of the franchise relationship that may be impacted be these types of laws. The potential costs related to each of these issues must be considered by the franchisor in deciding whether to enter a new market.

4. Competition and Antitrust Laws

Competition and antitrust laws vary by jurisdictions. Some countries, such as those in the European Union, have adopted laws similar, and in some instances more restrictive, to those in the U.S. Examples of such laws can include: prohibitions against collusion to limit consumer selection; price fixing; control over resale prices; control over internet sales; price discrimination; tying; false advertising; exclusive arrangements; exclusive and/or restricted territories; and, restrictions on the right to challenge trademarks.

5. Indemnification

Generally, indemnification provisions are enforceable, however; certain countries require the indemnified party to mitigate its damages and prohibit a party from receiving indemnification for its own intentional acts or gross negligence.

6. Dispute Resolution, Governing Law, and Venue

Even before the pandemic, arbitration was a favored approach by franchisors as a means of dispute resolution with international franchisees. This was generally because, assuming the foreign market in question is a party to the 1958 Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “New York Convention”), it is much easier to enforce an arbitration award over a court order. The flexibility and expedited nature of arbitration, which were once simple niceties, are now critical in the age of COVID-19. Virtual arbitration, which has existed to some extent for some time, is now ubiquitous and available by most leading arbitration centers, making the impact of pandemic related travel restrictions minimal.

As with much of the preceding, local counsel is essential for identifying any restriction or limitations in your target foreign market with respect to dispute resolution, governing law or venues provisions in your franchise agreement.

7. Personal Guaranties and Letters of Credit

It is common practice for franchisors to require personal guaranties from individual owners of franchisees—and sometimes their spouses—to ensure the owners remain personally liable for the franchisee’s obligations under the franchise agreement.

If a franchisor is confronted with a mature international franchisee that is unwilling to provide a personal guaranty, a corporate guaranty or even letter of credit may be alternatives.

8. Religious Concerns

Depending on the country, religious restriction can impact a business' operating hours and employee selection process, to its food preparation obligations. It is important to take these considerations into account when drafting a franchise agreement, as to provide your local partner with enough flexibility to adhere to the local requirements. In countries that operate under Sharia law, certain provisions in your franchise agreement may be deemed unenforceable (such as payments of interest on overdue amounts or noncompetition provisions).

I. EXTRA-TERRITORIAL APPLICATION OF U.S. LAWS

Unchanged by the pandemic, an awareness of the extra-territorial application of U.S. laws is vital to ensure ongoing compliance as you expand internationally. Failure to comply can have serious consequences.

1. US Franchise Laws

The prudent franchisor will reexamine domestic franchise laws which may apply to their international sale. While the Federal Trade Commission's Franchise Rule, 16 CFR Part 436 (the "FTC Rule") only applies to the offer or sale of a franchise to be located within the U.S., some state franchise registration and disclosure laws may apply to an international franchise transaction.

2. Anti-Corruption Laws

Under the Foreign Corrupt Practices Act ("FCPA"), U.S. companies, their officers and employees, as well as third party representatives or persons acting on their behalf, may not corruptly give or offer to give anything of value to a foreign government official for the purpose of influencing that individual in his official capacity, or causing that official to influence the foreign government in order to obtain or retain business. Franchisors must abide by the FCPA's ant-bribery provisions, however, there is no specific guidance as to liability for franchisee actions. Given a growing focus on enforcement, there is a chance that franchisors *could* be found liable under the FCPA for actions taken by franchisees as a result of the control franchisors exercise over them. Notably, although corrupt intent is a component of liability, a lack of knowledge may not avoid liability if you are "willfully blind" to the corrupt conduct. Prudent U.S. franchisors train their international teams to be sensitive to FCPA issues.

To minimize potential risk, the following should be considered: an appropriate FCPA compliance program (including compliance manual, education, and internal enforcement to ensure corporate compliance with FCPA requirements); due diligence of business partners, whether of agents, representatives or franchisees (particularly in jurisdictions where FCPA risks are heightened); inclusion of strong contractual language in franchise and other agreements regarding FCPA prohibitions and obligations; and implementation of an FCPA reporting and monitoring system.

3. Anti-Terrorism Laws

Countries, groups and individuals who are deemed to be a threat to U.S. national security, economic interests or foreign policy, can be subject to economic sanctions administered by the U.S. Office of Foreign Assets Control ("OFAC"). OFAC administers two types of sanctions: individual and country-specific. See https://home.treasury.gov/policy-issues/office-of-foreign-assets-control-sanctions-programs-and-information for more information.

U.S. franchisors are responsible for complying with the sanctions established by OFAC. Although no specific guidance has been issued specifically in the franchise context, it is likely that if a franchisor is deemed to have control over a franchisee and that franchisee violates OFAC sanctions, the franchisor will be liable. Because sanctions regulations create a strict liability regime, U.S. companies should consider conducting a risk assessment and establishing appropriate compliance controls. For franchisors, such controls can appear in franchise agreements and screening programs. If franchisors provide financing, guarantees, insurance or management services to an international franchisee, enhanced due diligence may be appropriate.

4. Anti-Boycott Laws

Antiboycott laws prohibit or penalize U.S. companies for participating in foreign-initiated boycotts and embargoes that the United States has not sanctioned—an example being the Arab League boycott of Israel. U.S. companies are subject to two antiboycott laws, the Export Administration Act ("EAA") and the Ribicoff Amendment to the Tax Reform Act ("TRA"). The prohibited activities include but are not limited to: refusals to do business with a boycotted country or with a blacklisted United States person; discriminatory actions on the basis of race, religion, sex, or national origin; furnishing information about race, religion, sex, or national origin; and furnishing information about business relationships with boycotted countries or blacklisted persons.

Franchisors must be sure that they do not contravene the U.S. antiboycott regime. While it is unlikely that a franchisor would be liable for a franchisee's violation, in an effort to avoid the possibility of liability, a franchisor should note the independent nature of the foreign franchisee. This documentation should emphasize that the franchisor does not exercise control over the franchisee's day-to-day business activities. This, coupled with strong compliance programs in effect at the franchise's corporate level, would be the best approach to protect your interests as a franchisor.

5. Anti-Money Laundering Laws

Money laundering is the process of disguising proceeds from illegal activities or funding illegal activities by mixing those proceeds with legal funds. Franchises with international locations often attract the scrutiny of financial institutions for signs of money laundering. As a result, franchisors should consider implementing programs to ensure their own compliance as well as try to identify potential issues with their franchisees. Such measures may include: identifying compliance officials; screening potential business partners; educating key personnel regarding anti-money laundering laws and compliance requirements; conducting continual risk assessment and being aware of potential red flags in proposed and existing business relationships; requiring compliance from business partners and franchisees; and, conducting internal audits.

J. CONCLUSION

COVID-19 has impacted nearly every facet of our lives. As a franchisor looking to expand internationally, much has changed in the decision-making matrix in the past 15 months because of the pandemic, but much too, remains the same. There are a number of fundamental issues franchisors must consider, many of which must now be assessed with an appreciation for the economic, public-health and travel implications of COVID-19.

At the end of the day, a franchisor must be able to assess its own abilities and recognize its strategic strengths in order to make a responsible decision on if, how and when it should pursue an international expansion. The pandemic has not changed the fact that the continued globalization of world economies and the growth of the global middle-class presents exciting opportunities for franchisors looking to expand their footprint. International expansion for franchisors has always posed a greater level of risk than domestic expansion. If anything, the pandemic has made it even more risky. Franchisors looking to expand in the middle of a pandemic need to reevaluate their risk tolerance levels and make decisions accordingly.

Professional Biography for Maral Kilejian

Maral Kilejian is a partner at the Dallas office of Haynes and Boone LLP, one of the *American Lawyer* top 100 law firms. Maral Kilejian focuses her practice in the areas of franchise and distribution law and advertising, marketing, and promotional law. Maral is a nationally-recognized franchise attorney who provides practical initial and ongoing counsel and legal support to franchisors in the structuring and operation of domestic franchise programs and international expansion, including in the drafting of franchise-related agreements, franchise compliance issues, franchise and business opportunity registrations and exemptions, non-traditional venues, alternative distribution channels, managing franchisee relationships, and crisis management. She represents franchisors in all stages of their business life cycle, from those just beginning to venture into franchising, to emerging brands, to mature multi-national franchisors. Maral is the co-chair of the Advertising, Marketing, and Promotional Law practice group and routinely advises clients on compliance, regulatory, and contract negotiation matters. She provides practical advice and guidance to clients regarding the structure and implementation of marketing and advertising campaigns, and both domestic and international promotions, contests and giveaways across various media, including text message promotions and social media campaigns. Maral is a Certified Franchise Executive, as designated by the International Franchise Association, a Franchise Times Legal Eagle (each year since 2016), and an active member of the American Bar Association's Forum on Franchising, currently serving as a member of the Forum's Marketing Committee. From 2015 until 2019, she served as a Topics and Articles Editor for the Franchise Law Journal, and from 2013 to 2015 she served on the Forum's Diversity Caucus's Steering Committee.

Professional Biography for Craig S. Prusher

Craig is the Executive Vice President, Chief Legal Officer and Secretary of Cajun Operating Company dba *Church's Chicken®/Texas Chicken®*. With more than 30 years' experience in franchise law, Craig brings a broad range of business and legal knowledge to the *Church's Chicken®* brand. He leads a team of top-performing lawyers and other legal professionals that find ways to help the company grow, mitigate risk, and provide business-oriented legal solutions to the problems that a global restaurant brand faces every day. He and his team provide strategic advice and counsel on all domestic and international legal issues facing the brand including franchising, human resources, restaurant operations, intellectual property, marketing, IT, finance, real estate, litigation, supply and distribution, and government affairs. He also provides strategic advice and counsel to the company's Executive Team and Board of Directors. Craig joined Church's Chicken after serving as Vice President, Assistant General Counsel at Burger King Corporation, where he oversaw all franchising, real estate and government affairs issues for more than 8,000 Burger King Restaurants in North and South America. Over the course of nearly two decades with Burger King, he progressed through a series of more senior positions including Senior Attorney, Franchising; Senior Attorney, Marketing and Promotions; and Division Counsel, Asia Pacific. Craig serves as Past Chairman of the Board of the National Council of Chain Restaurants, a leading restaurant industry trade association and is also an Adjunct Professor of Law at Emory University School of Law in Atlanta where he teaches a course in Franchise Law. Craig earned his Bachelor of Arts Degree, magna cum laude, in International Relations from Boston University in 1985 and his Juris Doctorate degree from Boston University School of Law in 1988.

Professional Biography for Larry Weinberg

Larry is a partner in the Toronto office of Cassels Brock & Blackwell LLP, a national Canadian law firm. Since 1989, he has had a practice that specializes in franchise law and providing all necessary legal services to franchisors. He is a member of the International Franchise Association, where he currently serves as Vice-Chair of its International Committee, and previously served as a Member of the IFA Board of Directors and as Chair of its Supplier Forum Advisory Board. Larry also currently serves as General Counsel to the Canadian Franchise Association, and is a member of the CFA Board of Directors. He is also the Immediate Past Chair of the International Bar Association's International Franchising Committee and is a Past-Chair of the Ontario Bar Association's Franchise Law Section. Larry was the founder of, and to date has organised and chaired four Ontario Bar Association annual franchise law conferences. He is a member of the American Bar Association's Forum on Franchising, and in 2006, he was the first Canadian lawyer to be appointed Director of the ABA Forum's International Division and to a leadership role on its Governing Committee. In 2009 he had the honor of being Co-chair of the ABA's 32nd Annual Forum on Franchising conference. In 2004 he acted as co-editor of the ABA Forum on Franchising's book entitled ***Fundamentals of Franchising-Canada***. In 2017, he again acted as co-editor of the 2nd edition of this publication. As well he was co-editor and co-author of the Canadian Franchise Association's first and still only official book publication entitled, ***How To Franchise Your Business***. He is a co-author of the chapter on Canada for the ABA Forum's book entitled ***International Franchise Sales Laws***. In 2004, 2005, and each year from 2009 to 2021 Larry was named by Franchise Times to their "Legal Eagles" list of the top franchise lawyers in the United States and Canada. He and Cassels Brock are each listed in the *Lexpert*® Canadian legal directory as being among the leaders in Canada in franchise law. In each year from 2014 to 2017 Larry received Who's Who Legal's one and only worldwide Lawyer of the Year award for Franchise law, and in 2014, the *Lexpert*® Zenith Award. Larry was called to the Bar of the Province of Ontario in 1989.