



Negotiating International Franchise Agreements

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NEGOTIATING INTERNATIONAL FRANCHISE AGREEMENTS

- 1. Language and Translation Issues**
- 2. Breach of Development Schedule**
- 3. Guaranties by Franchisee Owners**
- 4. Territory Rights and Exclusions**
- 5. Governing Law, Venue, Dispute
Resolution**

1: Negotiating Language Issues

- (Full Service Restaurant – U.S. Franchisor – Quebec Area Representative – like a subfranchisor except area rep does not sign the unit agreement.)
- Assume that franchisor has no manuals or materials previously in French, and no bi-lingual staff)
- Franchisor: Gary Duvall Representing Franchisor
- Franchisee: Joseph Adler Representing Area Rep

1: Negotiating Language Issues

Gary Duvall Representing Franchisor:

- **Franchisor will develop and register bilingual trademarks, as to the principle company brands.**
- **Franchisor will provide the area rep with training, manuals, and system in English only.**
- **Area rep must localize and translate manuals, systems, signage, unit agreements (even though area rep doesn't sign), all to be submitted to franchisor for approval, and will comply with French language law.**
- **Franchisor will own all translations.**

1: Negotiating Language Issues

Gary Duvall Representing Franchisor:

- **Ongoing Assistance.** Franchisor disclaims helping area rep create bilingual marketing to meet competition
- **Unit franchisee solicitation:** area rep will develop its own bilingual website; but franchisor will own the content.
- **Unit franchisee training:** area rep will first train unit franchisees, bilingually, then unit franchisees attend a shortened franchisor training in English. Unit franchisee pays for interpreter.
- **Unit franchisee bi-lingual support:** full responsibility of area rep

1: Negotiating Language Issues

Joseph Adler Representing Area Rep:

- **Which trademarks will not be registered in French?**
 - **Legislative amendments by Quebec govt. forthcoming?**
 - **Obtain indemnity for unprotected and registered marks**
- **Work made for hire inapplicable**
 - **Obtain assignment of copyright ownership from translators**
 - **Obtain indemnity for copyright infringements**
- **Seek reimbursement for:**
 - **Translation costs re: manuals, menus, marketing materials, websites & certain contracts of adhesion**

1: Negotiating Language Issues

Joseph Adler Representing Area Rep:

- Shortened English training will not be useful
- Avoid costs of arbitrating/litigating in English by choosing Quebec as governing law and venue
- Franchisor approval of translations/translators not to be unreasonably withheld or delayed
- How will Franchisor confirm the accuracy of the translations and bilingual training? Lost in translation, i.e., concerns re differing interpretations:
 - Diluting the brand
 - Potential liability to the public and to franchisor
 - Exempt area rep from liability for erroneous translation

2: Negotiating Termination for Failure to Meet Development Schedule

- (Home Health Care Service; Canadian Franchisor - US multi-unit developer franchisee candidate)
- Franchisor: Joseph Adler Representing Franchisor
- Franchisee: Gary Duvall Representing Multi-unit Developer Franchisee

2: Negotiating Termination for Failure to Meet Development Schedule

Joseph Adler Representing Franchisor:

- **Rapid market penetration key objective**
- **High demand for franchises and services in the US**
- **Development schedule is therefore critical – should be based on # of units and gross sales and on reasonable assessment of both parties**
- **Use month bank to provide multi-unit developer with opportunity to cure**
- **Force majeure provision is often overlooked**
 - **Address exclusions, inability to pay no excuse, right to terminate for extended force majeure event etc.**

2: Negotiating Termination for Failure to Meet Development Schedule

Joseph Adler Representing Franchisor:

- **Failure to meet development schedule, even after use of month bank, franchisor may employ any combination of the following:**
 - **Unilaterally extend schedule**
 - **Make territory non-exclusive**
 - **Appoint additional developers within territory**
 - **Permit franchisor to itself develop territory**
 - **Reduce size of development territory**
 - **Seek damages**
 - **Last resort: Terminate multi-unit development agreement**

2: Negotiating Termination for Failure to Meet Development Schedule

Gary Duvall Representing Multi-unit Developer Franchisee:

If developer doesn't meet the development schedule (and most are too optimistic)

- **Unit franchise agreements cannot be terminated; the developed units remain.**
- **There are aspirational targets only for the first 2 - 3 years but instead reasonable and diligent efforts is required.**

2: Negotiating Termination for Failure to Meet Development Schedule

Gary Duvall Representing Multi-unit Developer Franchisee:

- **Thereafter, cure periods are long; 1 – 2 years to cure as long as diligent efforts are being made.**
- **There is a stated percentage of leeway, e.g. if schedule is missed by more than one third for any two year period, it is breached.**
- **Targets may be reduced by a broad force majeure clause, e.g. for real estate and construction delays, or economic downturn**

2: Negotiating Termination for Failure to Meet Development Schedule

**Gary Duvall Representing Multi-unit Developer
Franchisee: If targets missed:**

- **First a duty to re-negotiate, then mediate, then arbitrate new targets. New targets will not vary by more than a stated percentage.**
- **Results depend on the degree of default, e.g. if the target is missed by 10%, there is a 10% reduction in the territory size or exclusivity (e.g. franchisor can introduce competing brands)**
- **Cure by payment of a fee of some of franchisor's projected income**

3: Negotiating Guarantees

- **(U.S. Franchisor; single unit franchisee of upscale hotel to be located in Ontario)**
- **Franchisor: Carl Hurwitz Representing U.S. Hotel Franchisor**
- **Franchisee Slides: Gary Duvall Representing Canadian Hotel Franchisee**

3: Negotiating Guarantees

Carl Hurwitz Representing U.S. Hotel Franchisor:

- **Payment and performance guaranty**
 - **Unsecured creditor**
 - **Sophisticated owners forming SPEs to serve as franchisee entity with no other assets**
 - **Need someone upstream in the ownership structure to go after if franchisee is not performing**
- **“Skin in the game”**
 - **Stand behind commitments and obligations**

3: Negotiating Guarantees

Carl Hurwitz Representing U.S. Hotel Franchisor:

- **Personal vs. Corporate**
 - **Much less likely to declare personal bankruptcy**
 - **Must be in ownership structure – consideration**
 - **Sufficient net worth – can't strip out assets**
 - **Net Worth Covenant with protection from “bad boy” acts**
 - **“Springing” guaranty that springs from a corporate guarantor to an individual if the corporate entity fails to perform within a specified timeframe**

3: Negotiating Guarantees

Carl Hurwitz Representing U.S. Hotel Franchisor:

- **Capped Guaranty**
 - Amount usually higher than any termination fee identified in the agreement, such as LDs
 - Indemnification obligations not included within the cap
- **Letter of Credit**
 - High carry cost
 - Indemnification obligations?

3: Negotiating Guarantees

Gary Duvall Representing Canadian Hotel Franchisee:

- **An un-capped guarantee may jeopardize guarantor's bankability, because it may be a material contingent liability in the guarantor's financial statement.**
- **If the franchisee has a significant net worth or the hotel has significant equity, there should be no guarantee needed, but just a covenant to maintain these.**
- **If there is an entity affiliate with sufficient assets, only that entity should be the guarantor, not individuals, but that entity guarantor should agree to financial covenants.**

3: Negotiating Guarantees

Gary Duvall Representing Canadian Hotel Franchisee:

- **If the entity franchisee meets the financial covenants in the hotel franchise agreement for 2-3 years, the guarantee should end.**
- **Springing guaranty: works only if the guarantor can control the “springing” event, for example, a parent can control franchisee’s working capital.**

3: Negotiating Guarantees

Gary Duvall Representing Canadian Hotel Franchisee:

- **Caps: Amount not greater than the liquidated damages calculation to terminate franchise agreement. Indemnity and other performance must be within the cap, or the guarantor's ability to get future financing will be impaired.**
- **Letters of credit are difficult due to the issuer's need to secure with deposits.**
- **If working capital and reserves are maintained at agreed levels, guarantees can be reduced pro rata.**

3: Negotiating Guarantees

Compromise Proposals – Negotiating Guarantees - (Joseph Adler):

- **Guarantee to be limited to cover key money only**
- **Restrict the guarantee to performance, not payment.**
- **Combination of:**
 - Limited guarantee
 - Letter of credit
 - Covenant to maintain certain ratios to ensure sufficient net worth

4: Negotiating Territories

- (QSR US franchisor; prospective Ontario master franchisee (subfranchisor))
- Franchisor: Carl Hurwitz Representing U.S. QSR Franchisor
- Franchisee: Joseph Adler Representing Ontario Master Franchisee (subfranchisor)
- Possible Compromises: Gary Duvall

4: Negotiating Territories

Carl Hurwitz Representing U.S. QSR Franchisor:

- **Recognize need for protection in early years to stabilize, but franchising is a growth vehicle**
 - Duration and distance is more of a business issue
- **Reservation of rights and exceptions to territorial protection**
 - Any existing unit
 - Replacement project
 - Competing brands/different trademarks
 - Acquisition of new brands/competing system
- **Alternate “non-traditional” sites, such as airport, mall, sporting stadium**

4: Negotiating Territories

Carl Hurwitz Representing U.S. QSR Franchisor:

- **Alternative forms of protection**
 - **Franchisor impact policy**
 - **Internal and Third Party impact studies**

4: Negotiating Territories

Joseph Adler Representing Ontario QSR Master Franchisee (subfranchisor):

- **Objectives:**
 - Clearly defined protected territory
 - Market research to confirm suitability of the territory
- **Concerns:**
 - Competition by franchisor or other franchisees
 - How reservation of rights will impact sales and profitability
- **Protected territory should not be contingent on:**
 - Development schedule compliance
 - Achieving a certain level of sales
 - Whether the initial term has yet to expire
 - A specific brand or brands if newly introduced brands will compete with those offered by the system

4: Negotiating Territories

Joseph Adler Representing Ontario QSR Master Franchisee (Subfranchisor):

- **Relieve encroachment by:**
 - Obtaining robust territorial rights during ramp-up period
 - ROFR for non-traditional sites (where possible) & other and competing brands and participation in any online sales
 - Right to share of profits
 - Reviewing & negotiating impact policy/procedures
- **Impact Policies for unprotected territories**
 - Obtain contractual assurances that a third party impact study will be commissioned and paid for by the franchisor
 - Pre-define adverse impact
 - Retain right of appeal or to seek mediation/arbitration

4: Negotiating Territories

Compromise Proposals – Territory - Ontario Master QSR Franchisee (Subfranchisor) (Gary Duvall):

- Franchisee is granted a right of first refusal to expand to: other brands, adjacent open territories, other channels that are practical, e.g. kiosks, mobile, other non-traditional locations, but not those that are not, e.g. airports.
- For online sales (e.g. of the “secret sauce” or merchandize), franchisee shares revenue to the extent practical, or that it adds value, e.g. a large ice cream franchisee delivers product to grocery stores. (But some not practical, e.g. delivery of McDonalds hats to Wal-Mart.)

5: Negotiating Governing Law, Venue and Dispute Resolution

- (Hotel – US franchisor, Canadian unit franchisee located in Ontario)
- Franchisor: Carl Hurwitz Representing U.S. Hotel Franchisor
- Franchisee: Gary Duvall Representing Canadian Hotel Franchisee

5: Negotiating Governing Law, Venue and Dispute Resolution

Carl Hurwitz Representing U.S. Hotel Franchisor:

- **Governing Law**
 - **Prefer law of country/state in which Franchisor is located**
 - **Provincial law often requires application of law of the province in which the Hotel is located**

5: Negotiating Governing Law, Venue and Dispute Resolution

Carl Hurwitz Representing U.S. Hotel Franchisor:

- **Arbitration preferred to Court/Jury Trial**
 - Typically less expensive (usually less legal-wrangling, faster process, less discovery)
 - More control over decision maker instead of jury or randomly-assigned state court judge with heavy docket
 - Legal precedent/chance for “bad” law. Arbitration award is not legal precedent, so losing may not establish “bad” law.
 - Certainty over rules and procedure
 - Flexibility and Informality
 - Confidentiality (court filings and hearings are public record, but arbitrations are not)
 - Finality (difficult to appeal arbitration ruling)

5: Negotiating Governing Law, Venue and Dispute Resolution

Gary Duvall Representing Canadian Hotel Franchisee:

- **Governing Law.** U.S. law may provide better remedies than Canadian provincial law to franchisees, with possible exceptions, e.g. Quebec and Ontario. Carve out for the relevant provincial franchise law.
- **Venue.** Hotel franchisees want the venue of dispute resolution to be in their own jurisdiction or a neutral jurisdiction.
- **Mediation.** Mandatory non-binding settlement negotiations and mediation by principals, in a neutral jurisdiction or franchisee's.

5: Negotiating Governing Law, Venue and Dispute Resolution

Gary Duvall Representing Canadian Hotel Franchisee:

- **Litigation in Canada is first choice over arbitration, because the courts are more efficient than in the US, with more limited discovery and no use of juries in most franchise disputes.**
- **Second choice is arbitration using Canadian arbitration services. (Third choice might be AAA international arbitration administered from NY.)**
- **Hotel agreements sometimes arbitrate valuation issues, but not everything.**
- **Many hotel franchisors won't arbitrate, possibly because they prefer the "hometown advantage" of courts in their own headquarters city.**

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