

# Franchising



If you're considering expanding your franchise business internationally, you need to know the "basics." Miller Canfield can help. We provide useful, reliable information on international franchising for both franchisors and franchisees.

The following overviews contain important franchising information on both established and emerging economies.

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## Franchising in China

### Franchise Regulations and Measures

Franchising in China has been regulated since 1997. But franchising by foreign franchisors was not expressly permitted until December 11, 2004, when the Measures for the Administration on Foreign Investment in Commercial Fields became effective.

The current franchising regulations, the Regulations on the Administration of Commercial Franchising, became effective May 1, 2007 (Franchise Regulations). The Measures on the Administration of Filing for Business Licensing (Registration Requirements) and the Measures on the Administration of Disclosure of Business Franchising Information (Disclosure Requirements) govern the registration of franchisors and disclosure requirements applicable to franchisees.

### What Constitutes a “Franchise” and Franchisor Qualifications?

The Franchise Regulations broadly define a “franchise” as business activities under one or more contracts in which a franchisor allows a franchisee to use the franchisor’s registered trademarks, business logos, patents, or other business resources, and the franchisee agrees to conduct business under the franchisor’s uniform business format and to pay franchise fees.

The Franchise Regulations establish several qualifications for the franchisor. The franchisor must be an enterprise, own a well-developed business format, and be capable of providing necessary support (business guidance, technical support, and training) to the franchisee.

The franchisor must have at least two stores which it has owned and operated for more than one year. Prior to 2007, this so called two + one qualification, required the stores to be located in China. The 2007 change permitting the “two + one” qualification to be satisfied by stores located outside China has vastly simplified and shortened the time for entry by a foreign franchisor into the Chinese market.

### Registration and Disclosure Requirements

The Registration Requirements require a franchisor to file specified documents with the Ministry of Commerce (or a provincial counterpart) within 15 days of signing its first franchise agreement. The filings are made through the MOFCOM website ([www.mofcom.gov.cn](http://www.mofcom.gov.cn)). MOFCOM is required to register the franchisor within ten days of receiving all required documents.

The filing must contain information relating to the franchisor and its store locations, a marketing plan, the franchisor’s business license, intellectual property rights, a sample franchise agreement, the franchise commercial prospectus, a catalogue of the franchising operational manual, any required governmental licenses or approvals applicable to the distribution of the franchised products or services, certificates evidencing satisfaction of the two + one qualification requirement, and other documents and information required by the Ministry of Commerce. Reports as to subscriptions of franchise agreements and alterations to the franchise agreement or the disclosure documentation must be submitted to the government on an annual basis. Alterations of the filed documentation must also be filed within 30 days.

The Disclosure Requirements require franchisors to provide a sample franchise agreement with specified disclosure documentation at least 30 days prior to entering into a franchise agreement with a prospective franchisee. The disclosure standards require the information provided be accurate and complete and the regulations provide the franchisee a termination remedy for concealing related information or providing false information.

The required disclosures include information as to the franchisor (including domicile, registered capital, business scope), the registered trademarks, patents, know how and business model of the franchisor, the franchise fees, prices and requirements as to products, services and equipment to be provided to the franchisee, the business, guidance, technical support and training to be provided, the quality, distribution and business evaluation of existing franchisees in China, summaries of two years audited financial statements and other financial and accounting information, an investment budget for the franchised business, and involvement in litigation and arbitrations during the last five years.

A written franchise agreement is required. The Franchise Regulations specify the required items to be covered in the agreement including franchisor and franchisee information, the term of the agreement (generally at least three years), franchise fees, support services to be provided by the franchisor, product and service quality and other standards, modification and termination of the agreement, liabilities for breach, and dispute resolution. A “cooling off” period is also required but the period is not specified in the regulations.

## IP Protections

Generally, trademark registration in China is a lengthy process. It is strongly recommended to register a trademark prior to the trademark owner entering the Chinese market.

Subject to specific exceptions, China follows a *first to file* rule, allowing the first person who files a trademark application the exclusive use of the mark within mainland China. China's Trademark Law, however, prohibits registration of a trademark that is considered identical or similar to a third party's well-known trademark that is not registered in China, provided that the use of such intended mark is similar to the use of the well-known trademark. It also prohibits registering a trademark that is considered identical or similar to a well-known trademark registered in China, even if it is intended to be registered under the different class.

Franchisors may also protect their intellectual property by copyright registration and design patent if applicable. Both copyright registration and design patents can protect trade dresses such as packaging, designs, visual appearance of a product, and even the design of a building or shop.

Trade secrets, such as know-how, are typically protected under Chinese laws, provided the franchisor takes reasonable steps to maintain confidentiality of the trade secrets including, for example, using protective non-disclosure agreements with parties having access to the trade secrets.

## Franchising in India

India presently prohibits foreign direct investment (FDI) in multi-brand retailing and only allows up to 51% FDI in single brand retailing. As a result, franchising has become one of the most popular modes of entry into India used by foreign companies. In fact, the Indian franchise industry is growing roughly at the rate of 40% per year and there are approximately more than 850 franchisors and 60,000 franchisees in sectors ranging from education and retailing to hospitality and healthcare.

### Franchise Regulation

There are no franchise-specific laws and no pre-disclosure requirements in India. Instead, franchises are subject to the general principles of contract law, much like other types of businesses. Generally, franchisors and franchisees are permitted to establish the majority of rules governing their relationship through the franchise agreement. The franchise agreement and exhibits can be written in a foreign language. Royalties and other payments to be made to a foreign franchisor pursuant to a franchise agreement may be made in a foreign currency. Under Indian law, a franchisor may restrict the franchisee's ability to transfer or assigns its rights under the franchise agreement.

India does not recognize judgments rendered by U.S. courts, thus it is generally most beneficial for U.S. franchisors to include a mandatory arbitration clause in their franchise agreement. While India recognizes U.S. arbitral awards, the Indian Arbitration and Conciliation Act, 1996 (Arbitration Act) allows Indian courts to use discretion on whether to enforce the arbitral awards or use them only as evidentiary support. Therefore, in order to ensure that the arbitral awards are recognized in India, the U.S. franchisors should make sure that the franchise agreement expressly excludes the application of Part 1 of the Arbitration Act.

### Franchise Fees and Royalties

The Indian government recently issued a press note allowing foreign franchisors to charge a lump-sum fee and royalty without any maximum limit for transfer of technology and royalty for use of trademark/brand name on the automatic route without requiring any prior approval from the Indian government. Prior to this press note, foreign franchisors could only charge royalties from the Indian franchisees up to 1% for domestic sales and 2% on exports for use of the foreign franchisor's brand name or trademark without transfer of technology and royalties up to 5% of domestic sales and 8% of exports and a payment of a lump-sum fee of up to U.S. \$2 million when the arrangement involved a transfer of technology. Arrangements involving payments above these limits had required prior permission of the Indian Government of India. While the Indian government has now fully liberalized royalty and lump-sum fees without any ceiling for the automatic route, all royalty and lump-sum payments remain subject to the Foreign Exchange Management Rules, 2000 as the rules may be amended.

### IP Protection

India is committed to protecting trademarks and brand names as well as the copyright and designs of the foreign franchisor. India is a signatory to the international conventions on intellectual property rights. To ensure protection, trademarks shall be registered. Once registered a trademark is valid for ten years, unless renewed and maintained before expiration. India also recognizes and protects service marks. As such, foreign franchisors can license their service marks to franchisees in India and to enable the franchisee to render the franchisor's services in India.

## Franchising in Mexico

### Franchise Regulation

The existing franchising legal framework in Mexico is set forth in the Industrial Property Law (IPL) and the Regulations to the IPL. Under the Regulations, the franchisor is required to disclose to the potential franchisee documentation relating to its business, commonly known as "Franchise Offering Notice," at least 30 days prior to entering into a franchise agreement. The Franchise Offering Notice should include

technical, economic and financial information, as well as the franchisor's and franchisee's rights and obligations under the franchise agreement.

The statutory regulations relating specifically to franchising are very limited in Mexico. Consequently, franchisors and franchisees are permitted to establish rules governing their relationship primarily through the franchise agreement. In an effort to promote franchising in Mexico, the Mexican Franchise Association together with the Mexican Association of Certified Quality developed and issued the "Mexican Franchise Standard." While compliance is voluntary, the Mexican Franchise Standard provides a series of valuable requirements for franchises, including the legal, operating and administrative, marketing, financial, and strategic requirements. The standards and requirements developed by the Mexican Franchise Standard have been fundamental in the development of the franchising industry in Mexico.

#### Intellectual Property Protection

Franchises in Mexico benefit from intellectual law protections offered by the IPL and its corresponding Regulation. The license for the use of the trademark, related to the products or services of the franchise, must be registered at the Mexican Institute of Industrial Property (IMPI) in order for it to be effective against third parties. The license application may be filed by any of the parties, and unless otherwise agreed, the licensee/franchisee will have the authority to exercise the legal actions to protect and defend the trademark rights. A trademark registration is valid for ten years and may be renewed for additional ten year periods. The registration with the IMPI only protects trademarks in Mexico.

Mexico is a member of certain international intellectual property conventions and recognizes priority date filings of registrations in other countries.

#### Other

Another significant factor impacting the growth and franchising opportunities in Mexico is the National Franchise Program (*Programa Nacional de Franquicias*). Specifically, the Ministry of Economy established a fund that, for several consecutive years, has been supporting acquisitions of franchises in Mexico. Among other incentives, the National Franchise Program grants 36 months credit to potential purchasers at 0% interest rate, which can be used to cover up to 50% of the startup cost (subject to applicable limits). In order to qualify, an acquired franchise must be included in the Ministry's "Certified Franchises Catalog." The investor can request to have a franchise certified and included in the Certified Franchises Catalog, to be eligible for this federal credit.

## Franchising in Poland

#### Franchise Regulation

There are no franchise-specific laws in Poland. Franchises are subject to the Polish civil and commercial law, like other types of businesses. There are no pre-contractual disclosure requirements in Poland, i.e., the franchisors are not required to provide their prospective franchisees with any formal documentation relating to their business. Furthermore, franchisors are not required to register their franchise agreements or any other franchise specific documents with the government.

#### Franchise Agreement

The franchise agreement and exhibits can be written in a foreign language, but any documents to be filed with the government must be translated into Polish. Royalties and other payments to be made to a foreign franchisor pursuant to a franchise agreement may be made in a foreign currency. The parties to a franchise agreement are free to choose the fee or royalty payment structure, subject to the applicable tax treatment. Under Polish law, a franchisor may restrict the franchisee's ability to transfer or assign its rights under the franchise agreement.

#### IP Protection

Franchisors in Poland benefit from intellectual law protections offered by the domestic and the European Union regulations. In order to ensure the broadest protections, franchisors often register their trademarks at the EU level. Trademarks may also be registered with the Polish Patent Office, whose records are available on-line. Once registered, a trademark is valid for ten years, unless renewed and maintained before expiration. Registration in Poland only protects the trademarks in Poland, while registration at the European Union level protects trademarks in Poland and all member states.

#### Antitrust

The anti-competition issues relevant to franchises in Poland are governed by the Polish Unfair Competition Act and the EC Treaty (Article 81). The EC Treaty applies to trade between members of the EU, while the Polish Unfair Competition Act applies domestically. Both sets of legal provisions have detailed rules and exemptions aimed at preventing monopolization within defined geographical areas. On April 20, 2010, the European Commission adopted a new Regulation (No 330/2010) listing the conditions under which vertical agreements (which can include franchise agreements) are exempt from the prohibition on anti-competitive agreements. The new rules went into effect as of June 2010 and replaced previous regulations and guidelines, and are to remain in force until May 2022. The new Regulation affects franchise arrangements in several ways, including restrictions on price fixing, territorial and customer limitations,

Internet sales, supply restrictions, and rules regarding covenants not to compete.

#### Other

Other legal regulations in Poland and EU may have a direct impact on franchising in Poland, which may be unfamiliar to non-European franchisors. One such regulation is the EU Data Protection Directive (95/46/EC) and the corresponding Polish Personal Data Protection Act of 1997. This law specifically controls and limits what kind of personal information may be collected about individuals, and how that information may be stored electronically and used on information systems. Any franchisor processing personal information is required to comply with eight principles of proper information handling.

## Franchising in the UK

### Franchise Regulation

There are no franchise-specific laws in the United Kingdom. Instead franchises are subject to the general principles of contract law, much like other types of businesses. However, the British Franchise Association (BFA), a self-regulatory and voluntary organization, has developed a code of business practice (Code of Ethics), which is followed by its members. The Code of Ethics includes, without limitations, regulations relating to franchisor's experience, fair dealing between the franchisor and its franchisees, and restrictions on advertising and recruitment of new franchisees. There are no pre-disclosure requirements in the UK. However, franchisors who are members of BFA are obligated to provide their prospective franchisees with a copy of the Code of Ethics. By joining the BFA, franchisors also agree to comply with the terms of its disciplinary procedure, complaints procedure, and appeals procedure.

### IP Protection

Franchisors in the UK benefit from intellectual law protections offered by UK law and European Union regulations. In order to ensure the broadest protections, franchisors often register their trademarks at the EU level. Trademarks may also be registered with the Register of Trade Marks in England, whose records are available on-line. Once registered, a trademark is valid for ten years, unless renewed and maintained before expiration. Registration with the Register of Trade Marks only protects the trademarks in the UK, while registration at the European Union level protects trademarks in the UK and in all member states.

### Antitrust

The anti-competition issues relevant to franchises in the UK are governed by the UK Competition Law and the EC Treaty (Article 81). The EC Treaty applies to trade between members of the EU, while the UK Competition Law applies domestically. Both sets of legal

provisions have detailed rules and exemptions aimed at preventing monopolization within defined geographical areas. On April 20, 2010, the European Commission adopted a new Regulation (No 330/2010) listing the conditions under which vertical agreements (which can include franchise agreements) are exempt from the prohibition on anti-competitive agreements. The new rules went into effect as of June 2010, and replaced previous regulations and guidelines, and are to remain in force until May 2022. The new Regulations affect franchise arrangements in several ways, including restrictions on price fixing, territorial and customer limitations, internet sales, supply restrictions, and rules regarding covenants not to compete.

#### Other

Another significant legal development impacting franchises doing business in the UK is the new UK Bribery Act 2010 (UK Bribery Act). The key feature of the UK Bribery Act is a new corporate offence for failing to prevent bribery. Franchisors might be liable for an act of bribery committed by any person performing services on their behalf. An offence is committed regardless of its geographical location in the world, as long as the entity charged with such offense has a business presence in the United Kingdom. In order to defend against a charge, a franchisor will have to demonstrate existence of adequate procedures designed at preventing bribery. The UK Bribery Act was scheduled to come into effect in April 2011, but the UK Ministry of Justice has recently decided to delay its implementation to provide more time for companies to establish necessary policies to comply with the new law.

Other legal regulations in the UK and EU may have a direct impact on franchising in the UK, which may be unfamiliar to the non-European franchisors. One such regulation is the EU Data Protection Directive (95/46/EC) and the corresponding UK Data Protection Act 1998. This law specifically controls and limits what kind of personal information may be collected about individuals, and how that information may be stored electronically and used on information systems. Any franchisor processing personal information is required to comply with eight principles of proper information handling.

**Contact us if you'd like assistance with your international franchising initiatives. We can discuss the challenges, identify the obstacles, and lead you to solutions for expanding your franchise internationally.**

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