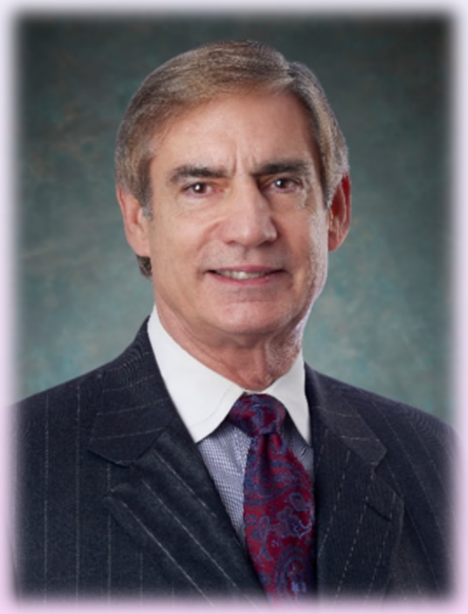
Global Franchise Regulation Update Webinar

Prepared by Carl Zwisler and Elizabeth Dillon

March 23, 2022

Lathrop GPM

Presenters



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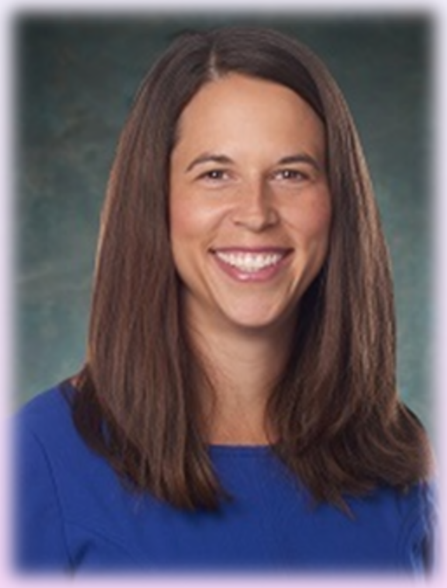

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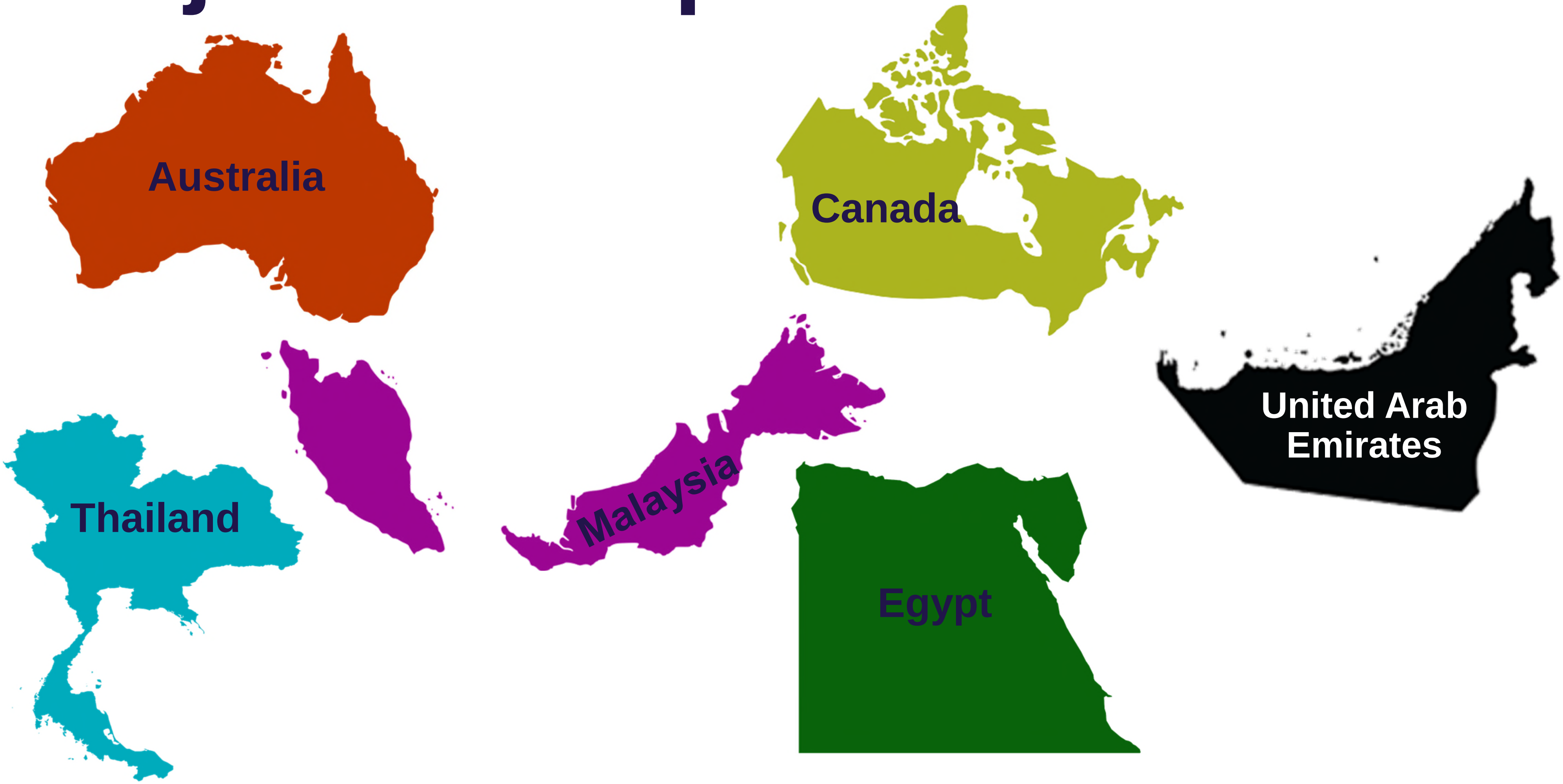
Major Developments



Australia

Proposed Amendments to Unfair Contracts Law

*Apply to form agreements signed by consumers and franchisees with 100 or fewer employees and less than A$10 million in annual sales.

*Eliminate A$300,000 or A$1 million annual payment ceiling for coverage.

*Unfair terms are still void, but violations would also carry stiff penalties.

A term will be presumed to be unfair if a court has held that the same or a substantially similar term is unfair in another proceeding in similar circumstances (i.e. used by the same entity or in the same industry).

"Unfair Contract Terms" are those that:

1. Enable one party (but not the other) to:
    a. avoid or limit their obligations under the contract;
    b. terminate the contract;
    c. vary the terms of the contract.
2. Penalize one party (but not another) for breaching or terminating the contract.

Key Facts Sheet

*Must be disclosed at least 14 days before franchisee makes a nonrefundable payment to franchisor or signing a binding contract.

- Designed to summarize 10 categories of information contained in FDD.
- Mandatory “yes” and “no” answers which can be misleading.
- “**Franchisor-franchisee disputes**: What percentage of franchisees in your franchise system were party to a mediation, conciliation or arbitration process in the last financial year? (Includes matters that went to or were awaiting mediation, conciliation or arbitration <u>in the last financial year</u>….”
  - o Beginning of year? End of year?
  - o Litigation in court is not included.

- If franchisor terminates a multi-unit franchisee with whom it is arbitrating during the year, is that franchisee included in a year-end count?

- **“The franchisor’s ability to change the franchise agreement (unilateral variation).**
  - “Can the franchisor change the franchise agreement without the franchisee’s consent?” Yes__ No__

- **“What happens at the end of the franchise agreement.”**
  - “Is the franchisee entitled to any compensation for goodwill in the business?” Yes__ No__
  - “Goodwill is not defined in the Franchising Code. It is important you seek independent legal advice.”

Penalties for Franchise Code and Unfair Contract Law violations are identical:

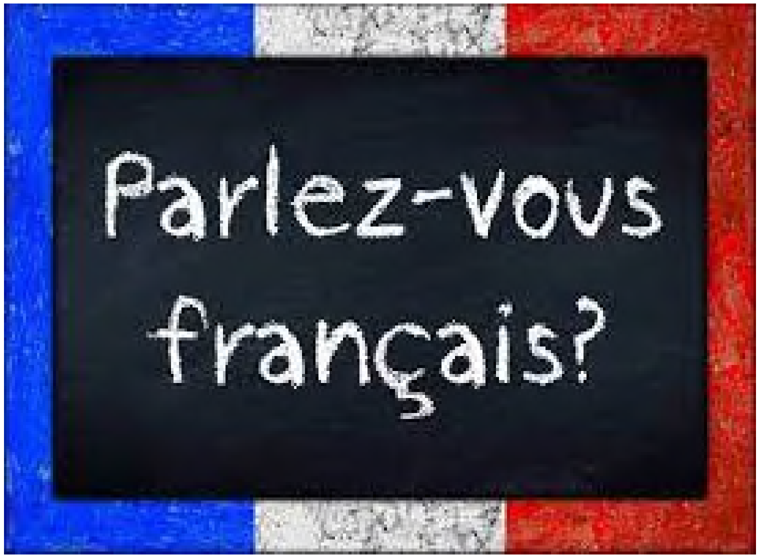
Courts may impose penalties which are the greater of:

1. A$10 million;
2. 3 X value of “benefit derived from the contravention;” or
3. 10% of previous year’s turnover.

Canada

Quebec—Government Proposes to Require Franchise and Other Form Contracts to Be Prepared in French.

- Amended Language Law would require franchise agreements and renewal agreements to be written in French to be enforceable.
- Following hearing in September & October 2021, the bill was referred to the Committee on Culture and Education for study.



Egypt

Proposed Franchise Regulation Is Being Redrafted.

- Following a hearing by a Congressional committee, a redrafted version of previously released franchise regulations, has been placed on hold while various stakeholders are consulted. As of January 30, 2022, the consultations had not yet been scheduled.
- The consensus of the Trade and Industry Committee at the hearing was that Egypt needs a franchise law.

Malaysia

March 2020 amendments to the Franchise Act clarifying sections of the Act under which foreign franchisors must register and rendering enforceable agreements previously registered by the Ministry of Domestic Trade and Consumer Affairs pursuant to the wrong section of the Act are still not effective.

(March 7, 2022)

Thailand

2020 Franchise Regulations required franchisors to give the closest franchisee the first option to acquire a franchise for a proposed new location for the brand.

The rights of area developers and others with contractual rights to acquire the new location were not considered.

2021 Amendments exclude from the law's first option rights, locations within territories that are subject to other franchisees' contractual rights.

United Arab Emirates

- According to newspaper articles—but no official sources—the UAE is considering several amendments to its Commercial Agency Law (CAL).

United Arab Emirates

New law would apply to all franchisees, that are partly owned (but not controlled) by foreigners. Current CAL only creates rights for companies wholly-owned by Emiratis.

CAL protects agents, distributors and franchisees from termination or nonrenewal absent good cause or mutual consent of the parties.

South Korea

- Franchise Law Amendments Promulgated
- Only franchisors with experience operating units for at least one year can franchise
- Additional disclosures required about online product sales
- Law now applies to smaller franchisors
- FTC given expanded authority to impose fines
- Effective November 2021

European Union

- EU proposes changes to Vertical Block Exemption Regulation.
- Affects how franchisors can regulate franchisee's use of e-commerce.
- Comment period on proposed regulations ended September 2021
- Final version to be published in May 2022, effective June 1, 2022.

United Kingdom

- UK's Competition and Markets Authority (CMA) recommends adopting a UK vertical restraints Block Exemption following Brexit
- Dual pricing and different criteria for on-line sales will likely cease to be hardcore restrictions
- Exemptions would permit exclusive and selective territories
- Will define active v. passive selling
- Come into force in June 2022
- Generally, aligns with EU proposed VBER, but key differences exist

Sharetea Australia Master Franchisee Obtains Interim Injunction Prohibiting Termination of its 80-unit Master Franchise Agreement

- Lian Fa of Taiwan has terminated the MFA of Sharetea Australia, allegedly because it refused to provide information about its subfranchises that Lian Fa needed for its pending IPO.
- The Australian master franchisee accounts for approx. 1/3 of Lian Fa’s global revenue.
- Sharetea Australia, refused to provide information, claiming that
  1) The information is confidential; and
  2) Sharetea Australia has no contractual duty to provide the information.

Sharetea Australia Master Franchisee Obtains Interim Injunction Prohibiting Termination of its 80-unit Master Franchise Agreement

- Lian Fa terminated the MFA and announced to Sharetea Australia that it would no longer supply its or its subfranchisees' stores with products needed to operate.
- Because the quality of locally-sourced products was inferior, subfranchisees voiced their frustration to Sharetea Australia.
- Lian Fa sued to stop Sharetea Australia's 90 stores from using the Sharetea brand.
- Citing the turmoil that granting an interlocutory injunction at this stage of the case would have on the master's and subfranchisees' relationships, the court denied the injunction and ordered the franchisor to resume supplying products—at least until a final ruling is issued by the court.

SUBWAY Russia Master Franchise Nonrenewal Dispute Demonstrates Effects of Sanctions and Challenges of International Franchising in a Belligerent Country – Before 2022 Ukraine Invasion

- Following the fall of the Soviet Union, Subway granted master franchise rights for Russia to Subway Russia in 1993 for 20 years, with 2 year renewal terms thereafter.
- MFA included performance requirements:

1) A development schedule;
2) A "McDonald's" clause—requiring the master franchisee to have no fewer restaurants than the largest fast food restaurant chain in Russia; and
3) An "AUV" clause, stated in US Dollars, requiring average restaurant sales volumes to meet or exceed a stated amount.

- Subway Russia confronted numerous problems getting the franchise launched, and it did not meet the development schedule until 18 years into the 20-year agreement.

SUBWAY Russia Master Franchise Nonrenewal Dispute Demonstrates Effects of Sanctions and Challenges of International Franchising in a Belligerent Country – Before 2022 Ukraine Invasion

- Nonetheless, Subway renewed the agreement twice, each time setting new performance standards.
- After the second renewal in 2013, Subway Russia had 700 restaurants operating, and was exceeding the AUV Clause and the McDonald's Clause.
- Then, Russia invaded Crimea, the West imposed sanctions on Russia, and Russia implemented a boycott of Western products, thereby cutting off all products Subway Restaurants needed to make their sandwiches.
- The Russian economy slumped, and the value of the ruble against the USD fell from 32 to 74.2. (On March 7, 2022 the rate was 137.81 to $1 USD.) Then the restaurant count fell from 700 to 456. The pandemic struck while a third renewal was being negotiated. Government restrictions caused all restaurants to be closed for certain periods.

SUBWAY Russia Master Franchise Nonrenewal Dispute Demonstrates Effects of Sanctions and Challenges of International Franchising in a Belligerent Country – Before 2022 Ukraine Invasion

- The parties reached agreement on all but two outstanding issues.
- Subway Russia claims that Subway agreed that in the Renewal Agreement, the AUV clause should be stated in rubles, and that a 20 unit annual growth requirement would replace the McDonald's clause.
- But…. 5 days from the expiration date, Subway asserted that Subway Russia had not accepted its last counteroffer, and was in violation of the performance standards in the existing agreement. Subway sent Subway Russia a notice of termination.
- Subway Russia replied: the violations are not material because Subway had agreed to change them in the renewal agreement; the performance clauses were suspended by a force majeure; and Subway had accepted Subway's renewal terms before the termination notice was sent.
- Subway Russia commenced arbitration in New York.

SUBWAY Russia Master Franchise Nonrenewal Dispute Demonstrates Effects of Sanctions and Challenges of International Franchising in a Belligerent Country – Before 2022 Ukraine Invasion

- The arbitrator concluded: the performance standards breaches were material and constituted good cause to terminate the agreement.
- Subway Russia appealed the ruling to the SDNY, which, in December 2021 upheld the termination, but it remanded the case to the arbitrator to conduct trial on the question of whether Subway Russia had actually agreed to a renewal agreement.
- Subway announced on March 9, 2022 that "[i]n addition to working with our franchisees across Europe to provide meals to refugees, we will redirect any profits from operations in Russia to humanitarian efforts supporting Ukrainians who have been affected by the war. Our restaurants in Russia are all independently owned and operated by local franchisees and managed by an independent master franchisee. We don't directly control these independent franchisees and their restaurants."

Mishap at Peruvian Restaurant Leaves Customer and Franchisor with Bad Tastes in their Mouths

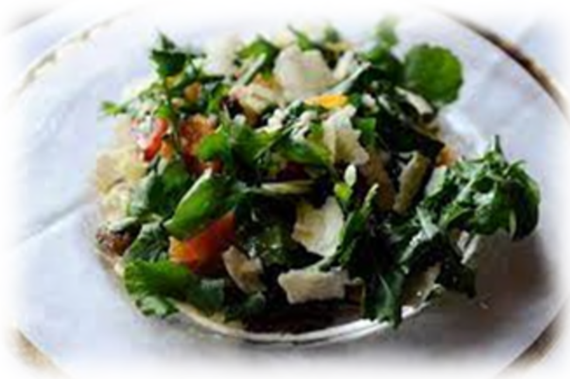
Can franchisors in Peru be liable for consumer protection law violations?

Indecopi

- Peru's Specialized Chamber for Consumer Protection of the Court of the Institute for the Defense of Competition and Protection of Intellectual Property (INDECOPI) has determined that the "Legal Appearance" presented by franchisees and their franchisors could make franchisors liable for misrepresentation and other consumer protection violations of their franchisees.

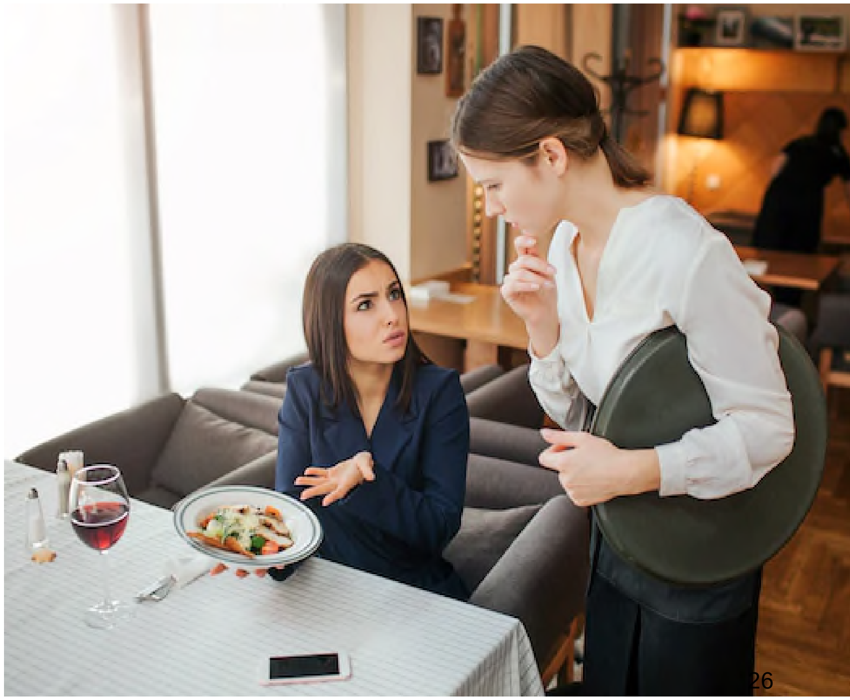
Mishap at Peruvian Restaurant Leaves Customer and Franchisor with Bad Tastes in their Mouths

- A diner at a franchised restaurant notified the restaurant after finishing her dinner that she had swallowed a worm that was in the salad that she was served. Despite a comped meal, and offer of other compensation, the customer complained 3 days later that she was experiencing stomach problems.



Mishap at Peruvian Restaurant Leaves Customer and Franchisor with Bad Tastes in their Mouths

- She filed a claim with INDECOPI against both the franchisee and the company she thought was the franchisor. In a 24-page opinion, INDECOPI wrote that because the franchisor and franchisee share the brand, and they share the "Legal Appearance," that the franchisor may be required to appear in the hearing to present evidence of its role in or right to control the misdeed.



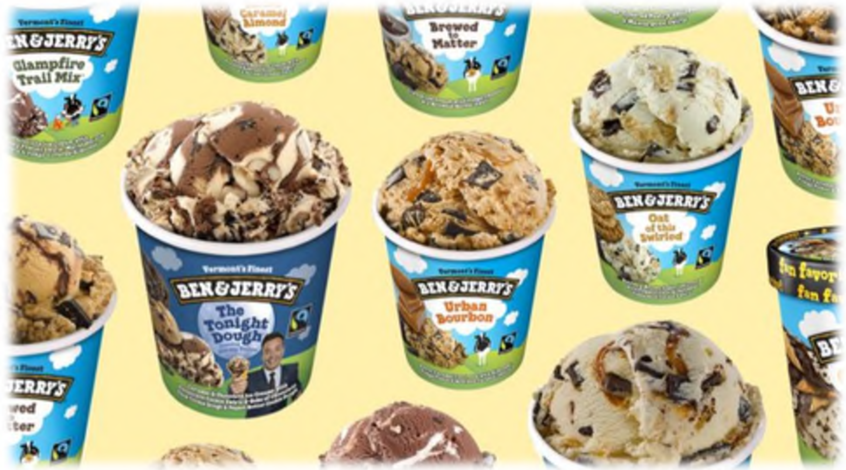
Israeli Ben & Jerry's Franchisee Sues to Stop Nonrenewal Arising from Its Insistence on Selling Ice Cream in Occupied Territories

- Because B&J's Israeli franchisee operated stores in Israeli Occupied Territories, Ben & Jerry's notified the franchisee that its 34-year-old franchise would not be renewed on 12/31/22.
- The decision was widely publicized, provoking protests from:
  - The current and former Prime Ministers of Israel.
  - U.S. Senators, who called for an investigation.
  - The Israeli Competition Authority which had granted special approve to the franchise grant.
  - Several state pension boards, which withdrew their investments in Unilever because the construed the decision as an unlawful boycott of Israel.
  - A group of U.S. franchisees, who claimed that the decision was depressing sales at their stores.
  - The B & J independent board of directors, who disagreed with its parent's board, about Unilever's statement that it would find a way to replace the present franchise arrangement.

Israli Ben & Jerry's Franchisee Sues to Stop Nonrenewal Arising from Its Insistence on Selling Ice Cream in Occupied Territories

On March 1, 2022 the franchisee sued B&J and Unilever in New Jersey Federal court, seeking:

- A declaration that the nonrenewal is unlawful and breaches the franchise agreement.
- An injunction to stop the nonrenewal.
- Damages.



Thank You