THANKS FOR THE MEMORIES: COMPENSATING FRANCHISEE GOODWILL AFTER FRANCHISE TERMINATION

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ABSTRACT

Franchises serve as a potential avenue through which direct investment can be made into new markets. However, the current state of franchise law and related concepts such as the franchisor's or franchisee's goodwill are still underdeveloped.

This Article reviews the franchise laws in key jurisdictions throughout the world. It considers, among other things, the treatment of goodwill upon termination of the franchisor-franchisee relationship. The Article argues for reforms, such as mandated pilot units prior to franchising.

Most importantly, this Article proposes the adoption of a presumption favoring goodwill compensation for the franchisee. The presumption could be rebutted by express contract provisions and, certainly, by wrongful behavior on the part of the franchisee, but a clear default standard in favor of franchisees would lead to a fairer, more efficient approach to franchise networks and investments.

KEY WORDS: goodwill, compensation, termination, comparative law, international law

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INTRODUCTION

Vincent: You know what they call a . . . a Quarter Pounder with Cheese in Paris?

Jules: They don't call it a Quarter Pounder with Cheese?

Vincent: They got the metric system, they wouldn't know what the f—- a Quarter Pounder is.

Jules: What'd they call it?

Vincent: They call it a Royale with Cheese.

Jules: Royale with Cheese. What'd they call a Big Mac?

Vincent: Big Mac's a Big Mac, but they call it Le Big Mac.

Jules: Le Big Mac. What do they call a Whopper?

*Vincent: I dunno, I didn't go into a Burger King.***

Franchising is a very common form of business expansion for companies both in the United States and abroad. In the United States alone, franchising "creates 21 million jobs at 900,000 locations nationwide and contributes $2.3 trillion in economic output annually."[1] While U.S. franchise law is far from uniform,[2] the federal and state laws describe a franchise in

** PULP FICTION (Miramax Films 1994).

1. Susan A. Grueneberg & Jonathan C. Solish, *Franchising 101: Key Issues in the Law of Franchising,* 19 BUS. L. TODAY, no. 4, Mar./Apr. 2010, at 11.

2. *See generally* 20 PAUL J. GALANTI, INDIANA PRACTICE, BUSINESS ORGANIZATIONS §

terms of three elements[3]: (1) the business is "substantially associated with the franchisor's trademark"; (2) the franchisee pays the franchisor a fee or series of fees for the right to operate the business; and (3) one of the following: (a) the franchisor prescribes a marketing plan, (b) the parties are interdependent and share a financial interest (the "community of interests" standard), or (c) the franchisor exerts significant control over the business.[4] If a business relationship fulfills all three elements, it is a franchise by law.[5]

Other countries define franchises by these elements as well. Some countries define a franchise using only two out of three elements or a variation thereof, but the definition remains similar throughout the world. Most countries do not require a franchisor to test the business plan or concept before offering a franchise to a prospective franchisee.[6] There are some notable exceptions, however, such as China.[7]

One of the more debated issues in franchise law concerns which party, the franchisor or the franchisee, owns the business goodwill at the termination of the franchise agreement.[8] In other words, does the goodwill of the business, the franchise's reputation vis-à-vis its customer,[9] stay with

54.4 (2009) (focusing on Indiana franchise law, and noting that different states may have different registration and/or disclosure laws).

3. Grueneberg & Solish, *supra* note 1, at 11.

4. *Id.* at 11–12. This last element will vary by jurisdiction. *Id.* The marketing plan applies in California and most other states. *Id.* Some states use the "community of interests" standard. *Id.* The FTC uses the significant control standard. *Id.* at 12.

5. IND. CODE ANN. § 23-2-2.5-1 (West 2015); MINN. STAT. ANN. § 80C.01 (West 2016).

6. Some such nations with no testing requirement, as discussed *infra*, are Australia, Canada, India, Japan, and the United States. *See infra* notes 29, 164, 195, 249, 264 and accompanying text.

7. *See infra* note 74 (including a "mature business plan" as one of the requirements a franchisor must meet).

8. *See, e.g.*, Robert W. Emerson, *Franchise Goodwill: "Take a Sad Song and Make it Better*," 46 U. MICH. J.L. REFORM 349 (2013) (proposing a standard for reducing the major stresses of a franchise relationship by quickly and fairly resolving the ownership of goodwill); Benjamin A. Levin & Richard S. Morrison, *Who Owns Goodwill at the Franchised Location?*, 18 FRANCHISE L.J. 85 (1999) (examining who is entitled to protect the value of local goodwill when a franchise relationship ends); Clay A. Tillack & Mark E. Ashton, *Who Takes What: The Parties' Rights to Franchise Materials at the Relationship's End*, 28 FRANCHISE L.J. 88, 124–25 (2008) (discussing who owns the local goodwill associated with a particular franchised location and who is entitled to payment for it when a franchise agreement terminates).

9. In franchising:

> [A] well-recognized and respected trademark can become a business asset of incalculable value, usually referred to as goodwill[, which] develops as a result of *favorable consumer recognition and association*. Trademark law is designed to protect business goodwill by protecting consumers from confusing various producers of goods or providers of services.

Christopher P. Bussert & Linda K. Stevens, *Trademark Law Fundamentals and Related*

the franchisor upon termination or does the franchisee deserve compensation for building up the goodwill during the contract term (local goodwill)? Goodwill is usually defined as:

> [T]he advantage or benefit, which is acquired by an establishment, beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement, which it receives from constant or habitual customers, on account of its local position, or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances, or necessities, or even from ancient partialities, or prejudices.[10]

Courts in different countries will give varied treatment to goodwill upon termination. Some courts hold that the goodwill always remains with the franchisor.[11] Others recognize the franchisee's right to full or partial compensation based on goodwill.[12] Even though this issue is very important for international franchising, the ownership of and compensation for goodwill has yet to be explored in many countries.[13] This failure to consider and regulate franchise goodwill is especially striking inasmuch as the principles of agency law established in most of these nations might well apply.[14]

Part I of this Article surveys the existing franchise laws of a broad range of about a dozen nations worldwide. For each country, Part I's discussion considers (a) the governing franchise laws and definitions in the country and whether business formula testing is required for the franchisor to sell the

Franchising Issues, *in* FUNDAMENTALS OF FRANCHISING 1, 6 (Rupert M. Barkoff et al. eds., 4th ed. 2015).

10. JOSEPH STORY, COMMENTARIES ON THE LAW OF PARTNERSHIP AS A BRANCH OF COMMERCIAL AND MARITIME JURISPRUDENCE, WITH OCCASIONAL ILLUSTRATION FROM THE CIVIL AND FOREIGN LAW § 99, at 139 (1841).

11. *See infra* Parts E.2. (stating that goodwill compensation to a franchisee is not recognized in Canada) & I.2. (showing that goodwill compensation is generally not awarded in Japan).

12. *See infra* Parts C.2. (France), D.2. (Brazil), F.2. (Australia), G.2. (Germany) & H.2. (India) (indicating that goodwill compensation has been recently recognized in at least one case in each of these countries).

13. *See infra* Parts B 2 (stating that China does not recognize goodwill beyond what was provided for in the franchise contract) & J.2 (finding that courts in the United Kingdom have yet to award franchisee goodwill).

14. *Compare* Inga Karulaityte-Kvainauskiene, *Lithuania: Court of Appeal of Lithuania passed an important ruling in a case related to commercial agency*, INT'L DISTRIBUTION INST., Oct. 20, 2015 (citing a Lithuanian case where goodwill compensation was awarded based on agency principles) *with* Peter Gregerson, *Denmark: No compensation to a Danish distributor upon termination*, INT'L DISTRIBUTION INST., Feb. 16, 2011 (citing a Danish case that did not award goodwill compensation in a distributorship agreement despite an agency relationship because the distributor was not an exclusive distributor).

franchise and (b) how goodwill is treated at the end of a franchise relationship. Part II recommends the adoption of a consistent standard for franchise law and the uniform treatment of goodwill to increase efficiency in franchise investments and operations.

I. SURVEY OF FRANCHISE LAW AND TREATMENT OF GOODWILL

A. *United States of America*

1. Business Formula

The United States was the first country to adopt franchise laws when the State of California passed the *California Franchise Investment Law* in 1971.[15] The United States does not have a uniform definition of what a franchise is across all fifty states.[16] Numerous states as well as the Federal Trade Commission (FTC) have adopted franchise disclosure laws,[17] with some states requiring a filing or registration and some states even having substantive requirements.[18] Of the states that have adopted franchise laws, most share certain baseline requirements, including the substantial association with a trademark, payment of a fee, and a franchisor-designed marketing plan.[19] Still, states often apply a variety of standards to determine if a franchise relationship exists.[20] A few states, including New York, only require a franchise fee and either a marketing plan or use of a trademark.[21] Due to this lack of uniformity, "the definition in each applicable law or

15. Susan A. Grueneberg & Jonathan C. Solish, *Franchising 101: Key Issues in the Law of Franchising*, 19 A.B.A. BUS. LAW SEC. 4 (Mar./Apr. 2010), available at http://apps.americanbar.org/buslaw/blt/2010-03-04/grueneberg-solish.shtml [https://perma.cc/DS2F-9WJM] (explaining the basic legal framework of franchising in the United States).

16. John R.F. Baer & Susan Grueneberg, *United States*, *in* INTERNATIONAL FRANCHISE SALES LAWS 499, 503 (Andrew P. Loewinger & Michael K. Lindsey eds., 2d ed. 2015).

17. *See* Robert W. Emerson, *Franchise Contract Interpretation: A Two-Standard Approach*, 2013 MICH. ST. L. REV. 641, 661 (2013) (outlining the federal and state franchise disclosure requirements); Baer & Grueneberg, *supra* note 16, at 503-07 (detailing federal and state disclosure and registration laws and highlighting state registration laws, such as in California and New York).

18. *See* Robert W. Emerson, *Franchise Terminations: "Good Cause" Decoded*, 51 WAKE FOREST L. REV. 103, 106 n.18, 108-10 (2016) (delineating the states with laws specifically on franchising and also detailing how state franchise laws require "good cause" before a franchisor can terminate a franchise); Emerson, *supra* note 17, at 662 n.121 (citing the laws of 19 states as well as some territories that govern the franchise relationship rather than simply the disclosures and registrations before a franchise may be granted).

19. Grueneberg & Solish, *supra* note 15.

20. *Id.*

21. *Id.* at 12.

regulation must be reviewed by a franchise seller . . . ."[22]

Even though the FTC rules for franchises apply in all fifty states, state franchise law can preempt the federal law.[23] As such, the FTC mandates a floor level of protection for franchises, which can only be enhanced by any applicable state law provisions.[24]

The FTC defines a franchise as a continuing commercial relationship where the franchise seller, orally or in writing, promises:

> That the franchisee will have the right to operate a business identified by the franchisor's trademark, or to offer, sell, or distribute goods or services with the franchisor's trademark;
> That the franchisor can exert *significant* control over the franchisee's method of operation *or* provide *significant* assistance in the same;
> *And* that before commencing operations as a franchisee, the latter is required to make payment or commit to make a payment to the franchisor.[25]

All elements must be present for a business relationship to be considered as a franchise. The absence of just one element precludes the business from franchise classification.[26]

However, it is possible for a relationship to be considered a franchise under the FTC, but not treated as a franchise under state law when lacking an additional element required under a state law; or vice versa.[27] Likewise, a business relationship may be a franchise in one state, but not qualify as one in another state.[28] Furthermore, there is no requirement in the United States

22. Baer & Grueneberg, *supra* note 16.

23. *Id.*; *see also* John R.F. Baer, *Overview of Federal and State Laws Regulating Franchises, Distributorships, Dealerships, Business Opportunities and Sales Representatives*, UNIDROIT 2 (March 14, 2012), http://www.unidroit.org/english/guides/2007franchising/country/usa.pdf [https://perma.cc/6JAL-LWTM] ("The Amended FTC Franchise Rule does not preempt the state disclosure laws, except to the extent that the state laws are inconsistent.").

24. Baer & Grueneberg, *supra* note 16, at 529-31; *see also* 16 C.F.R. § 436 (2007) (stating that a law is not inconsistent with Part 436 if it affords prospective franchisees equal or greater protection than that provided by Part 436, such as registration of disclosure documents or more extensive disclosures).

25. 16 C.F.R. § 436.1(h) (2007).

26. *See* Baer & Grueneberg, *supra* note 16, at 506-07; FEDERAL TRADE COMMISSION, FRANCHISE RULE 16 C.F.R. PART 436 COMPLIANCE GUIDE 1 (May 2008), https://www.ftc.gov/system/files/documents/plain-language/bus70-franchise-rule-compliance-guide.pdf [https://perma.cc/N4K3-KN5M] ("A business arrangement described as a 'franchise' will not be covered unless it meets the three definitional elements in the amended Rule.").

27. Baer & Grueneberg, *supra* note 16, at 503.

28. *Id.*; Lauren Fernandez, Timothy O'Brien, & Felicia N. Soler, *Disclosure Basics Under Federal and State Franchise Laws*, 18 (May 2013).

"The fifteen states featuring their own franchise disclosure laws are California,

for the franchisor to test a franchise concept "before offering it for sale."[29]

2. Goodwill

Goodwill treatment by American courts varies significantly dependent upon the state in which the case is brought. Resolving who owns the goodwill after termination of the franchise contract presents a dilemma that is best characterized as follows: "On the one hand, the franchisor has provided the trademarks that the location's customers recognize. But on the other hand, the franchisee's efforts hopefully have improved the brand's goodwill and may even have developed goodwill that is unique to that specific location."[30]

At the federal level, the goodwill associated with a trademark belongs to the franchisor.[31] In comparison, state law diverges into separate categories; some states require franchisors to pay the franchisee for local goodwill generated during the life of the contract while others require

> Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington and Wisconsin. Of those fifteen states, all but Oregon are so called "registration/disclosure states" because they also require a pre-sale filing with the state. In California, Hawaii, Illinois, Maryland, Minnesota, New York, North Dakota, Rhode Island, Virginia, and Washington, a franchisor must first register itself and its FDD, a daunting task for the uninitiated, before any franchise advertising appears, any franchise offers are made or any franchise sale is affected. In Indiana, South Dakota and Wisconsin, only a "notice filing" and dissemination of the FDD is required; that document is not reviewed prior to use. Michigan requires only the filing of a Notice of Franchise Offering. And, as stated above, under Oregon law, only disclosure is mandated, without any prior registration."

Id.

29. Carl E. Zwisler, *Country Report United States: Franchising,* INT'L DISTRIBUTION INST. 41-42 (last updated November 7, 2014). Although there is no requirement to use the business formula, it has been suggested that doing so leads to greater success since what the franchisor is ultimately selling "is a 'system' or part of one's 'business expertise' and the proven track record of a product." John W. Wadsworth, *United States*, *in* 2 INTERNATIONAL FRANCHISING U.S.-1/6 (Dennis Campbell ed., 2005). This would presumably apply not only in the United States but in other countries as well.

30. Tillack & Ashton, *supra* note 8, at 124.

31. Kerry L. Bundy & Robert M. Einhorn, *Franchise Relationship Laws*, *in* FUNDAMENTALS OF FRANCHISING 183, 216 (Rupert M. Barkoff et al. eds., 4th ed. 2015). This is derived from the Lanham Act, the federal trademark act that states that in a trademark license agreement the goodwill is owned by the licensor. "To the extent that the franchisee is a licensee of the franchisor, the goodwill associated with the license trademarks is owned by the franchisor[.]" Thomas M. Pitegoff & W. Michael Garner, *Franchise Relationship Laws*, *in* FUNDAMENTALS OF FRANCHISING, 212 (Rupert M. Barkoff & Andrew C. Selden eds., 3rd ed. 2008).

compensation for loss of goodwill in cases of wrongful termination.[32] The statutes of Delaware, Indiana, Minnesota, Mississippi, Missouri, Nebraska, New Jersey,[33] and Virginia all fall under the second category.[34] These states do not require repurchase of the goodwill by the franchisor upon termination unless the franchisor violates the agreement of the relevant franchise laws.[35] If repurchase is required, then goodwill compensation would be included in a franchisee's damages against the franchisor in a lawsuit.[36]

In contrast, the franchisor must pay the franchisee for the local goodwill the franchisee helped create during the relationship in only three states[37]: Hawaii,[38] Illinois,[39] and Washington.[40] Aside from tangible goodwill, these statutes generally require compensation for goodwill when either the franchisor benefits from the franchisee's goodwill or when the franchisee is precluded from benefiting from its goodwill because of an enforceable non-compete agreement.[41] If the franchisee is released from the non-compete agreement or the franchisor does not operate in the same location as the previous franchisee, these statutes are unclear regarding whether the local goodwill benefits the franchise at the national level, leaving these determinations to the common law.[42]

The Hawaii, Illinois, and Washington statutes apply only under limited circumstances. First, the Hawaii statute limits the goodwill payment requirement by restricting it to instances where the franchisor refuses to renew for the purpose of converting the franchise into a company-owned

32. Tillack & Ashton, *supra* note 8, at 88.

33. Jiffy Lube Int'l, Inc. v. Weiss Bros., Inc., 834 F. Supp. 683, 692 (D.N.J. 1993) ("Grounds for irreparable injury include loss of control of reputation, loss of trade, and loss of goodwill.") (quoting S & R Corp. v. Jiffy Lube Int'l, Inc., 968 F.2d 371, 378 (3d Cir. 1992)). The court granted a preliminary injunction to protect the goodwill of the franchisor. *Id.* at 693–94.

34. Bundy & Einhorn, *supra* note 31, at 216.

35. *Id.*

36. *Id.*; 15 U.S.C. § 1117(a) (2016) (stating that "actual damages" can be in the form of goodwill and must be proven).

37. Bethany L. Appleby, John Haraldson & Karen C. Marchiano, *Life After Termination: Ensuring a Smooth Transition*, INT'L FRANCHISE ASS'N, 5 (2015) ("In addition, the franchise statutes in Hawaii, Illinois, and Washington require franchisors to pay their former franchisees for local goodwill generated during the life of the relationship in certain circumstances.").

38. HAW. REV. STAT. § 482E-6(3) (2016).

39. 815 ILL. COMP. STAT. 705/20 (2016).

40. WASH REV. CODE § 19.100.180(2)(i) (2014).

41. *See* Craig R. Trachtenberg, Robert B. Calihan & Ann-Marie Luciano, *Legal Considerations in Franchise Renewals*, 23 FRANCHISE L.J. 198, 204 (2004) (discussing the application of the Illinois, Hawaii, and Washington statutes).

42. *Id.*; Bundy & Einhorn, *supra* note 31, at 216 (stating various state laws in which a franchisor may be found liable for damages of goodwill to the franchisee).

outlet.[43] The Illinois statute, although it does not specifically use the term "goodwill," effectively requires reimbursement of it.[44] Specifically, if the franchisor refuses to renew the franchise agreement, it must pay compensation to the franchisee "for the diminution in the value of the franchised business" where: "the franchisee is barred by the franchise agreement . . . from continuing to conduct substantially the same business under" a different mark in the same area, or the franchisor did not inform the franchisee of its intent not to renew at least six months prior to the expiration date of the franchise agreement.[45]

Finally, the Washington state statute[46] requires payment for goodwill upon the franchisor's refusal to renew the franchise agreement unless: "the franchisee has been given one-year's notice of nonrenewal," and "the franchisor agrees in writing not to enforce any covenant which restrains the franchisee from competing with the franchisor[.]"[47]

The Hawaii, Illinois, and Washington statutes might recognize what is known as sweat equity,[48] the goodwill that reflects the going-concern value of the business, which is separate from the trademark.[49]

The common law itself is no clearer. Take, for example, two conflicting federal cases, *Lee v. Exxon Co., U.S.A.* and *Atlantic Richfield Co. v. Razumic*. In *Lee,* the court determined whether goodwill was part of a sale between the franchisor and franchisee. Exxon, after deciding not to renew the franchise

43. HAW. REV. STAT. § 482E-6(3).

44. 815 ILL. COMP. STAT. 705/20.

45. *Id.*

46. The statute was recently reviewed in *MetroPCS Pa., LLC v. Arrak*, No. C15-0769JLR, 2015 WL 6738887 (W.D. Wash. Nov. 4, 2015).

> MetroPCS, a wireless telephone carrier, sought to enjoin a terminated dealer from continuing to offer competing products and services, in breach of noncompetition/nonsolicitation restrictions in the terminated dealer agreement . . . . The court noted that Washington State law enforces noncompetition/nonsolicitation restrictions that are reasonably necessary to protect a franchisor's business or goodwill, giving special consideration to time and area restrictions.

Earsa R. Jackson & David Gurnick, ANNUAL FRANCHISE AND DISTRIBUTION LAW DEVELOPMENTS 34 (2016).

47. WASH. REV. CODE § 19.100.180(2)(i) (2014).

48. Bundy & Einhorn, *supra* note 31, at 216.

49. *See* Russell Cohen, *What is Goodwill?*, MURPHY BUSINESSES BROKER RUSSELL COHEN (May 19, 2015), http://www.sflabusinesses4sale.com/what-is-goodwill [https://perma.cc/37AX-LB2Y] ("Goodwill is often viewed as an approximation of the value of a company's brand names, reputation or long-term relationships that cannot otherwise be represented financially."). The going-concern value, on the other hand, is the idea that the business will continue and essentially not go bankrupt. It is the "value of a business for just being in business[.]" *Id.*; *see also* Bundy & Einhorn, *supra* note 31, at 216 (noting that "sweat equity" is distinct from the brand and instead "reflects the 'going-concern' value of the franchised business separate from the goodwill associated with the trademark").

agreement with Lee, offered to sell it back to Lee at the same price as the highest bid offered in the market.[50] Lee sued Exxon claiming that the price included the goodwill he had built up during the contract period and hence was too high.[51] The court did not find this to be a valid claim.[52] Instead, it observed, "Congress has . . . declared that where a franchisor follows the provisions of the [relevant franchise/trademark law] . . . , the franchisor may terminate or non-renew a franchise . . . ."[53] The termination or non-renewal could take place without the franchisor "incurring any liability to the franchisee, including any payments for the loss of alleged goodwill."[54]

In *Atlantic*, on the other hand, the court ruled in the opposite direction, declaring that in effect "a franchisee does create goodwill for the franchise . . . ."[55] The court specifically stated that "[u]nlike a tenant pursuing his own interests while occupying a landlord's property, a franchisee such as Razumic builds the goodwill of both his own business and Arco [(the franchisor)]."[56] The court then went on to say that a franchisee "can justifiably expect that his time, effort, and other investments promoting the goodwill of [the franchise] will not be destroyed" by the franchisor's termination.[57]

In yet another case, *Bray v. QFA Royalties LLC,* the court differentiated between business goodwill, which the franchisees claim they lose if the franchisor is allowed to terminate the franchise, and trademark goodwill, which is associated with the franchisor's brand and can be damaged if the franchisee continues to operate.[58] This distinction implies that the business goodwill is owned by the franchisee and the trademark goodwill by the franchisor.[59] This is consistent with the concept of sweat equity, implied by the Hawaii, Illinois, and Washington state statutes.[60]

50. Lee v. Exxon Co., U.S.A., 867 F. Supp. 365, 366 (D.S.C. 1994).

51. *Id.* at 368.

52. *Id.* ("Plaintiff's 'goodwill' theory is not a recognized basis to vitiate or reform the sale to him.").

53. *Id.* In *Lee*, the relevant trademark law was the Petroleum Marketing Practices Act (PMPA), 15 U.S.C. §§ 2801-2806 (2006 & Supp. V), which focuses on the termination or nonrenewal of gas station dealerships. *See* Emerson, *supra* note 8 at 362 n.64 ("Principles of PMPA interpretation may also be applied to non-petroleum franchise cases.").

54. *Lee*, 867 F. Supp. at 368.

55. Emerson, *supra* note 8, at 363.

56. Atlantic Richfield Co. v. Razumic, 390 A.2d 736, 742 (Pa. 1978).

57. *Id.*

58. Bray v. QFA Royalties LLC, 486 F. Supp. 2d 1237, 1252, 1254–55 (D. Colo. 2007).

59. Emerson, *supra* note 8, at 365.

60. *See supra* Part I.A.2; *see also* Gaylen L. Knack & Ann K. Bloodhart, *Do Franchisors Need to Rechart the Course to Internet Success?*, 20 FRANCHISE L.J. 101, 140 (2001) (citing *Computer Currents Publ'g Corp. v. Jaye Comm., Inc.*, 968 F. Supp. 684 (N.D. Ga. 1999), where the court found that a franchisee may own goodwill in the form of customer data collected through the franchisee's efforts, distinct from the goodwill attributable to the

B. *China*

1. Business Formula

As Chinese economic power has grown, so too has the Chinese franchising fervor. There are hundreds of stories of booming franchises – both foreign-based and domestic – in China, but the tale of KFC is surely most prominent. In 1987, KFC opened its first store in China.[61] Today KFC operates over five thousand stores in China, serving nearly a thousand cities.[62] However, as of 2016, only 24% of all KFCs in China were franchised, rather than owned and operated by Yum! Brands Inc., the parent corporation of KFC.[63] By comparison, in the United States, there are approximately 4,979 KFC units, of which 4,199 stores (over 84%) are franchised.[64] One potential explanation for this discrepancy in terms of the percentage of franchises versus company-owned units is the more mature legal and business landscape of franchising in the United States – the certainty of that law, financing, and marketing, compared to the comparative infancy of Chinese franchising matters.

It was only after joining the World Trade Organization (WTO) that China began to reform its franchise law.[65] By 2007, the State Council and the Ministry of Commerce had developed a body of law governing all commercial franchise activity in China.[66] These new laws defined the franchisor-franchisee relationship for the first time.[67] In China, a franchise is an arrangement whereby: an enterprise contractually grants other operators the right to use its business operating resources, including trademarks, logos, patents and know-how; the franchisee conducts business under a uniform mode of operation ("i.e., one that can be applied to all aspects such as management, promotion, quality control, interior designs of

franchisor's trademark).

61. David Bell & Mary L. Shelman, *KFC's Radical Approach to China*, HARV. BUS. REV. 137, 138 (Nov. 2011).

62. Yum! Brands, Inc., Annual Report 4 (Form 10-K) (December 26, 2015).

63. *Id.*

64. *KFC Corporation*, INT'L FRANCHISE ASS'N, http://www.franchise.org/kfc-corporation-franchise [https://perma.cc/4P8T-HEDP] (last visited Nov. 3, 2017).

65. Yu Qin & Richard L. Wageman, *China*, *in* INTERNATIONAL FRANCHISE SALES LAWS 139, 142 (Andrew P. Loewinger & Michael K. Lindsey eds., 2d ed. 2015).

66. Jue Tang, *CHINA: The New Regulations on Franchise*, INT'L DISTRIBUTION INST. (Apr. 18, 2007), http://www.idiproject.com/news/china-new-regulations-franchise [https://perma.cc/2A74-3DPM] ("The text will not repeal the currently in force 2004 Measures on Administration of Commercial Franchising, but rather the two shall co-exist.").

67. Ella S.K. Cheong, *China*, *in* INTERNATIONAL FRANCHISING CHN/4 (Dennis Campbell ed., 2d ed. 2016).

stores, and even the arrangement of the brand display board"[68]); and "the [f]ranchisee pays franchise fees according to the agreement."[69] Both individuals and enterprises can conduct commercial activity as a franchisee; however, only an enterprise can be a franchisor.[70]

The Chinese courts have followed the definition set by the State Council very closely. In *王静(Wang Jing) v. 北京阳光瑞丽美容有限公司(Beijing Ruili Sunshine Beauty Co., Ltd.)*, the Beijing court determined that the "franchisor was required to provide a complete management experience, including the defendant's technology," since the parties' agreement had all the characteristics of a franchise agreement.[71] In another case, the court found that there was no franchise agreement because the contract did not involve the licensed use of intellectual property or a unified business model,[72] two important elements of a franchise under Chinese law.

In yet another Beijing case, the court agreed that, since there was no license to use intellectual property in the parties' agreement, there was no franchise agreement, only a sales agency contract.[73] Based on these cases, if any of the critical elements are missing, the courts will find a sales agency relationship exists instead of a franchise relationship. When all the elements are present, Chinese courts will enforce the agreement as a franchise and make the parties comply with the requirements under franchise law.

China requires that before a franchisor can engage in franchising, they have:

"a mature business model";

"the capacity to provide a franchisee with operational guidance, technical support and training services"; and

68. *Id.* at CHN/5.

69. *See* Qin & Wageman, *supra* note 65, at 142 (discussing the definition of a franchise according to regulations in China).

70. Tang, *supra* note 66; Shangye Texujingying Guanli Banfa Diqi Tiao (商业特许经营管理办法第七条) [Administrative Measures on Commercial Franchise, Article 7] (promulgated by the Ministry of Comm., Dec. 30, 2004, effective Feb. 1, 2005), *translated with* WESTLAW CHINA, http://westlawchina.com [https://perma.cc/JE93-GTXP].

71. Paul Jones, *Country Report: People's Republic of China – Franchising*, INT'L DISTRIBUTION INST. § 2.1 (last updated Feb. 2010) (citing Wang Jing, Bei Jing Yang Guang Rui Li Mei Rong You Xian Gong Si (王静, 北京阳光瑞丽美容有限公司) [Wang Jing v. Beijing Ruili Sunshine Beauty Co., Ltd.], 朝民初字第17784号 (Beijing Chaoyang Dist. People's Ct. 2008)).

72. *Id.* (citing Zhao Bin, Jiang Su Long Li Qi Sheng Wu Ke Ji Gu Fen You Xian Gong Si (赵斌, 江苏隆力奇生物科技股份有限公司) [Zhao Bin v. Jiangsu Longli Qisheng Biotechnology Co., Ltd.], 苏中知民终字第0003号 (Jiangsu Province Suzhou City Interm. People's Ct. Aug. 6, 2008)).

73. *Id.* (citing Tian Jin Shi Jin Sui Shui Kong Ji Shu You Xian Gong Si, Tai Ji Suan Ji Gu Fen You Xian Gong Si (天津市金穗税控技术有限公司, 太极计算机股份有限公司) [Tianjin Jinsui Tax Technology Co., Ltd. v. Taiji Computer Co., Ltd.], 海民初字第25608号 (Beijing Haidian Dist. People's Ct. Nov. 17, 2008)).

"at least two directly-operated units operating for more than one year."[74]

The last requirement is the "2+1" requirement.[75] Any two stores, whether in China or abroad, can count towards this requirement.[76]

Franchisor and franchisee are free to contract for territorial exclusivity in China.[77] However, if such a clause is not explicit in the contract, the franchisee cannot claim the right.[78] Neither cases nor legal issues have arisen in China concerning the duties of the franchisor under such exclusivity provisions.[79]

2. Goodwill

Generally, Chinese law "does not provide for compensation beyond damages" for violations of the franchise agreement.[80] The law leaves this up to the parties to contractually provide such compensation.[81] Accordingly, treatment of goodwill in the specific context of franchising is underdeveloped in China. Under agency and distributorship principles, which can apply to franchises, the contract usually provides that the agent (franchisee) has a right to be paid for goodwill established during the contract

74. Zhongguo Shangye Texu Jingying Guanli Tiali (中国商业特许经营管理条例) [Regulations for the Administration of Commercial Franchising Operations] (promulgated by St. Council of the P.R.C., Jan. 31, 2007, effective May 1, 2007), *translated in* Brad Luo, *Regulations for the Administration of Commercial Franchising Operations–China Franchise Regulations (I)*, FRANCHISE ASIA (May 23, 2007, 8:44 AM) (hereinafter, "Commercial Franchising Operations").

75. Yanling Ren, *China*, GETTING THE DEAL THROUGH: FRANCHISE 2013, 47, 49 (Philip F. Zeidman ed., 2013). *See also* Paul Jones, *People's Republic of China: The Beijing No. 1 Intermediate Court again interprets the 2+1 Rule as being Administrative only*, INT'L DISTRIBUTION INST. (Mar. 13, 2011), http://www.idiproject.com/news/peoples-republic-china-beijing-no-1-intermediate-court-again-interprets-21-rule-being [https://perma.cc/5KVL-R44G] (noting that a franchise contract is not invalid for violating the 2+1 Rule; rather, the franchisor is subject to an administrative penalty).

76. Ren, *supra* note 75, at 49. *See* Robert W. Emerson, *Franchisees as Consumers: The South African Example*, 37 FORDHAM INT'L L.J. 455, 470 ("Under prior laws, international franchisors could only meet the '2+1' requirement by having two franchises that were *within* China's borders for one year, regardless of whether the franchisor had franchises in other countries. These earlier laws brought franchise expansion in the country to a crawl."). Thus, the Chinese authorities replaced them with provisions allowing experienced foreign franchisors to meet the pilot-units requirement before these franchisors even come to China, and that has led to more rapid, foreign-based franchise development within China. *Id*. at 470-71.

77. Jones, *supra* note 71, at § 8.1; Qin & Wageman, *supra* note 65, at 156.

78. Jones, *supra* note 71, at § 8.1.

79. *Id*. at 16 (§ 8.2).

80. *Id*. at 23 (§ 14).

81. PETER JIANG, *China*, *in* 1 INTERNATIONAL AGENCY AND DISTRIBUTION LAW CHI-19 (Dennis Campbell ed., 2nd ed., 2017).

period if:

> (a) [A]fter the termination, the [franchisor] gains increased profits from the transactions with clients introduced by the [franchisee]; (b) [d]ue to the termination, the [franchisee] cannot get the commissions which are otherwise payable to him based on the contracts signed or to be signed with the clients introduced by the [franchisee]; and (c) . . . it shall be fair and reasonable if the [franchisee] receives compensation.[82]

These requirements are consistent with other countries' agency laws.

Chinese courts also consider other types of regulations, such as whether the franchisee has improved on the technological know-how of the franchisor. For example, in a technology transfer agreement, which can and does apply to the franchise relationship, the parties can contract about sharing any subsequent improvements resulting from the franchisee using the technology or know-how of the franchisor.[83] If sharing is not stipulated in the contract or it is unclear, then neither party is entitled to share any subsequent improvement made by the other party.[84] Presumably, this would mean that the franchisee would not be entitled to a goodwill compensation fee for any improvements it made that resulted in increased clientele.

Further, under Chinese law, if a franchise relationship consists of a foreign franchisor[85] and a Chinese franchisee, the parties may select non-Chinese governing law and even a foreign court for litigating disputes.[86] Thus, the goodwill laws of other countries could apply to a foreign franchisor-domestic franchisee relationship. Because of the youth of Chinese franchise law[87] and the frequent use of non-Chinese law through choice-of-law provisions, cases dealing with franchise goodwill treatment are either nonexistent or so few they are impossible to find. However, agency law will

82. *Id.*

83. LIU XIAOHAI, *Unfair Competition/Trade Secrets/Know-How*, *in* CHINESE INTELLECTUAL PROPERTY AND TECHNOLOGY LAWS 127, 140 (Rohan Kariyawasam ed., 2011).

84. Contract Law of the People's Republic of China (promulgated by the Second Session of the Ninth Nat'l People's Cong., March 15, 1999, effective October 1, 1999) at Art. 354.

85. "Foreign franchisor" in this scenario includes not only nationals of other countries but also parties from Hong Kong, Taiwan, and Macau. Qin & Wageman, *supra* note 65, at 157.

86. *Id.* at 157-158. A franchise contract between a Chinese franchisor and Chinese franchisee is governed by Chinese law. *Id.*; *see also* Luo Junming, *Choice of Law for Contracts in China: A Proposal for the Objectivization of Standards and Their Use in Conflicts of Law*, 6 IND. INT'L & COMP. L. REV. 439, 441–42 (1996) (interpreting the Supreme Court of the People's Republic of China as providing that parties can agree upon a choice of law clause in their contracts); Michele Lee, *Franchising in China: Legal Challenges When First Entering the Chinese Market*, 19 AM. U. INT'L L. REV. 949, 971 ("Foreign parties to a contract may choose which law to apply in contractual disputes.").

87. *Supra* notes 65-67 and accompanying text.

likely provide the basis for deciding goodwill compensation in China.[88]

Unlike the mainland, Hong Kong franchise law is much more developed with respect to addressing goodwill compensation. In Hong Kong, "the license to use the franchisor's business format must be subject to the express condition that all goodwill acquired and reputation established by the franchisee will accrue exclusively to the franchisor."[89] In other words, there is no goodwill compensation for the franchisee since all improvements or local goodwill goes to the franchisor. However, if the franchisee "has established an earlier reputation in the franchisor's name in Hong Kong, it will be difficult for the franchisor to [bring suit for infringement or a claim of ownership to the goodwill for that matter], and the only option would be purchase of the [franchisee's] business and goodwill."[90]

C. *France*

1. Business Formula

France has no set legal framework for what constitutes a franchise.[91] One of the earliest French attempts to define franchises was a 1973 administrative order, which described a franchise as an agreement whereby one party allows another the right to use a trademark to sell products.[92] However, this definition is no longer used.[93] Rather, the French Franchise Federation now defines franchises in the same terms as the European Code of Ethics for Franchising (established by the European Franchise

88. *See generally* 1 JAMES M. ZIMMERMAN, CHINA LAW DESKBOOK: A LEGAL GUIDE FOR FOREIGN-INVESTED ENTERPRISES 191-197 (4th ed. 2014) (providing general information on franchise, retail, wholesale, and commission-based agency operations in China).

89. Ella Cheong & Andrea Fong, *Hong Kong*, *in* 1 INTERNATIONAL FRANCHISING LAW, H.K.-12 (Dennis Campbell ed., 2005).

90. *Id.*

91. Robert W. Emerson, *Franchise Savoir Faire*, 90 TUL. L. REV. 589, 613 (2016); Emmanuel Schulte, *France, in* GETTING THE DEAL THROUGH: FRANCHISE 62, 64 (Philip F. Zeidman ed. 2014).

92. *See* Odavia Bueno Diaz, FRANCHISING IN EUROPEAN CONTRACT LAW: A COMPARISON BETWEEN THE MAIN OBLIGATIONS OF THE CONTRACTING PARTIES IN THE PRINCIPLES OF EUROPEAN LAW ON COMMERCIAL AGENCY, FRANCHISE AND DISTRIBUTION CONTRACTS (PEL CAFDC), FRENCH AND SPANISH LAW 48 (2008).

> In a decision of 1973, the Tribunal de Grand Instance of Bressuire defined franchising as *a contract where one undertaking licenses to other independent undertakings in exchange for remuneration, the right to use the franchisor's registered name and trademark to sell products and services. This agreement generally implies the provision of technical assistance*.

Id.

93. *Id.*

Federation[94]), requiring the following elements for a franchise: a system of marketing goods/service/technology, based upon a close, ongoing collaboration, whereby the franchisor grants to the franchisee the right to conduct business in accordance with the franchisor's concept; the right entitles the franchisee to use the franchisor's "trade name, and/or trademark and/or service mark, know-how, business and technical methods, procedural system . . . and/or intellectual property rights . . . ."[95] This definition is taken into consideration by French courts.[96]

Although there is no explicit legal requirement in France to test the franchise formula prior to offering a franchise for sale, the requirement is implied.[97] Régulation R330-1 of the French Commercial Code states that a franchisor must disclose "ainsi que toutes indications permettant d'apprécier l'expérience professionnelle acquise par l'exploitant ou par les dirigeants."[98] Restated in English, the franchisor must disclose the information necessary to assess the *experience* gained by the managers or other directors of the enterprise.[99] Furthermore, case law describes a franchise as a reiteration of commercial success.[100] The franchisor must then be able to prove, before selling a franchise, "that it has operated at least one similar commercial business, in a manner and for the time necessary to consider such business as a success."[101]

Under French law, parties entering into a franchise agreement are permitted to include an exclusivity provision.[102] However, the franchisee is

94. *European Code of Ethics for Franchising,* POLISH FRANCHISE ORGANIZATION, http://franchise.org.pl/code-of-ethics (last visited Jan. 29, 2017).

95. *Id.* (emphasis omitted).

96. Schulte, *supra* note 91, at 65.

97. Didier Ferrier, *Country Report France: Franchising*, INT'L DISTRIBUTION INST. 5 (last updated Dec. 2012).

98. CODE DE COMMERCE [C. COM.][COMMERCIAL CODE] art. R330-1 (Fr.), *available at* http://www.legifrance.gouv.fr/affichCodeArticle.do?cidTexte=LEGITEXT000005634379&idArticle=LEGIARTI000006266469&dateTexte=&categorieLien=cid [https://perma.cc/B5HG-AA2J].

99. *Id.*

100. Didier Ferrier & Nicolas Ferrier, DROIT DE LA DISTRIBUTION 387-388 & 391 (7th ed. 2014).

101. *Id.*

102. Didier Ferrier, *Country Report France: Franchising*, INT'L DISTRIBUTION INST. 8 (last updated Dec. 2012); Olivier Binder Granrut, *What is the Impact of the New Contract Law and the Macron Act on Franchise Agreements?* 3 (2016).

> Franchise agreements, related agreements and any distribution agreement that includes an exclusive or quasi-exclusive clause, are subject to Article L.341-1 of the French Commercial Code, which provides that "*all contracts (i) concluded between a person making available to an operator of a retail business a trade name, a trademark or a store brand in consideration of an exclusive/quasi-exclusive commitment and (ii) "the shared purpose of which is the operation of one or several retail outlets which include clauses which are liable to limit the*

not entitled to exclusivity as a legal right.[103] If such a provision is included, obligations include similar restrictions as those in other countries- mainly that the franchisor is not permitted to sell directly in the territory or appoint another franchisee to that territory.[104] In 2006, the Cour de Cassation, France's supreme court for judicial matters, decided that direct Internet sales by other franchisees to customers in the exclusive territory are not a violation of an exclusivity provision.[105]

2. Goodwill

Until recently under the French system, the goodwill in a franchise remained with the franchisor.[106] Unless there are contractual provisions stating otherwise, "all technology, know-how, and other industrial property rights remain the property of the franchisor after termination of the contract . . . ."[107] However, as early as 2000, France began to recognize the franchisee's right to goodwill. For example, in *Sarl Nicogli Le Gan Vie SA* (2000), the Paris Court of Appeals ruled that goodwill belongs to the franchisee and is independent of the franchisor's goodwill, holding that "the party that would risk and suffer financial loss by losing the goodwill owned it in the first place."[108] This holding demonstrates the viewpoint that

> *freedom of the outlet's operator to carry on his business*", shall all have the same expiry date.

Id.

103. Ferrier, *supra* note 97, at 8; *see also* Robert W. Emerson, *Franchise Encroachment*, 47 AM. BUS. L. J. 191, 208 n.75 (2010) (noting a 2002 decision of France's highest court of ordinary jurisdiction that franchisees cannot expect territorial protections unless stipulated in the franchise agreement).

104. Ferrier, *supra* note 97, at 8; *But see* CA Paris, July 3, 2013*, Odysseum c/ Le Polygone* no. 11/17161 (holding that exclusivity clauses are not entirely sheltered from the application of competition laws).

105. *Id.*; *see also* Robert W. Emerson, *Franchise Territories: A Community Standard*, 45 WAKE FOREST L. REV. 779, 792 n. 56 (2010) ("The contract also should directly address nontraditional methods of marketing and distribution—possible encroachment via dual-branding and Internet sales, for example.").

106. KPMG, *Taxation of Cross-Border Mergers and Acquisitions*, 3 (2014) https://home.kpmg.com/content/dam/kpmg/pdf/2014/05/france-2014.pdf [https://perma.cc/3AGV-3QLF].

> Under French tax rules, goodwill, which is considered an intangible asset, generally cannot be amortized except by the creation of a provision, subject to strict conditions. The value of the goodwill is included in the net worth of the company. If goodwill is transferred, it must be included in the recipient company's accounts.

Id.

107. Robin T. Tait, *France*, *in* SURVEY OF FOREIGN LAWS AND REGULATIONS AFFECTING INTERNATIONAL FRANCHISING France-11 (Philip F. Zeidman ed., 2d ed. 1990).

108. Pierre-François Veil, *A Question of Goodwill,* INTERNATIONAL LAW OFFICE (Oct. 23,

goodwill is no longer a singular aspect of the franchise system. Instead, the franchisor's goodwill encompasses the regional, national, or international scale; whereas the franchisee has its own local goodwill.[109]

By 2002, the idea that goodwill was not just the sole property of the franchisor had taken root.[110] The Cour de Cassation in March 2002 decided a case that involved a lessor who refused renewal of a franchisee's commercial lease because the franchisee did not indicate that it had its own clientele.[111] The court ruled that while "the franchisor is the owner of the national clientele," the local clientele belonged to the franchisee.[112] More specifically, the court decided, on the one hand, that if the clientele at the national level attaches to the fame of the franchisor's trade name, then, on the other hand, the local clientele exists only due to the planning and execution of efforts by the franchisee. The franchisee owns and controls local elements of the goodwill, the materials and stocks, and the intangible element that is the commercial lease; the franchisee's clientele is part of the franchisee's goodwill, because even if the franchisee does not own the mark and the trade name it used while making and performing the franchise contract, the franchisee created goodwill through its activity (with methods and behavior that the franchisee put in place at its own risk). Therefore, the "franchisees were the owners of the goodwill on the local scale."[113] Unfortunately, since landowners continue to ignore the goodwill rights of franchisees, these franchisees continue to run into difficulties when renewing their leases.[114]

2001).

109. *Id.*

110. Robert W. Emerson, *Franchise Contracts and Territoriality: A French Comparison,* 3 ENTREPRENEURIAL BUS. L.J. 315, 344 (2009).

111. *Id.* at 345 n.128. In France, "the right to renew a lease may only be claimed by the owner of the business that is carried on at the premises." CODE DE COMMERCE [C. COM.] art. L. 145-8, *translated in* THE FRENCH COMMERCIAL CODE IN ENGLISH 68 (Philip Raworth, 2009). This has been interpreted as the owner of the goodwill. Emerson, *supra* note 110, at 345 n.127.

112. *Id.* at 345.

113. *Id.*

114. *Id.*; Civ. 3: Bull. 2002 III No. 77 P.66 Application for review no., 00-20732 Case Trévisan v. Basquet.

> [H]aving rightly found that, (i) on the one hand, while from the national point of view goodwill ('clientèle') is attached to the notoriety of the name of the franchisor, locally goodwill ('clientèle') exists only by reason of the means employed by the franchisee, among which are the corporeal elements of his business ('fonds de commerce'), the equipment and stock, and the incorporeal element which is the lease (ii) this goodwill ('clientèle') is itself part of the business ('fonds de commerce') of the franchisee, since, even if he is not the owner of the name and the trade mark put at his disposal during the performance of the contract of franchise, it is created by his activity by means which he

The concept that the franchisee owns the local goodwill has led to other developments in franchise law, mainly that franchisees can transfer the local goodwill.[115] As a result, most franchising contracts involve a *clause de preference*, or preference clause, whereby the franchisee agrees to grant the franchisor preemptive rights, similar to a right of first refusal, if and when the franchise decides to sell the goodwill.[116] If the franchisor refuses, then the franchisee is free to transfer the right to anyone.[117]

Franchisors can contractually protect themselves from this situation in multiple ways, such as by including both a preference clause and an agreement clause in their contracts.[118] This means that the franchisor still has a preemptive right to buy the franchisee's local goodwill, but can also authorize which third party the local goodwill is transferred to and can ensure that the third party is governed by the franchise contract.[119] Another option is a *Clause de libre-circulation, sous condition résolutoire de performance* (free circulation clause, under termination if unsatisfactory performance).[120] Under this clause, the franchisee can freely transfer the goodwill, but the franchisor is given several months to evaluate the third party purchaser.[121] If the franchisor is unsatisfied, the transfer is invalid.[122]

> exploits at his own risk, since he contracts personally with suppliers or lenders, (iii) on the other hand the franchisor recognised that the Basquet spouses had the right to dispose of the elements which made up their business ('fonds de commerce'), the Court of Appeal rightly deduced that the tenants had the right to claim the payment of an indemnity for eviction, and for these reasons alone, justified in law its decision on this point . . . .

Id.

115. Emerson, *supra* note 110, at 346.

116. *Id.* at 346; *see also* Cour de cassation [Cass.] [supreme court for judicial matters], Mar. 23, 2010, Bull. civ. III, No. 77, p. 66 (Fr.) (ruling that a franchise contract does not exclude the existence of goodwill owned by the franchisee).

117. Emerson, *supra* note 110, at 346. This was affirmed in a 2005 French appellate court decision where the franchisor did not exercise its preemptive rights and the franchisee proceeded to sell the goodwill to a third party. *Id.* When the third party did not follow the franchise contract's requirements, the franchisor sued. *Id.* The court ruled that the contract was terminated when the goodwill was transferred and the only available recourse to the franchisor was to sue the original franchisee for damages. *Id.* The third party was not liable to the franchisor. *Id.*

118. *Id.* at 346-347.

119. *Id.* at 347. For more information on agreement and preference clauses, *see generally* François-Luc Simon, *Le Contrat de Franchise: un an d'actualité* [*The Franchise Contract: a year of current affairs*], 224 PETITES AFFICHES 1, 31–34 (2006) (discussing the agreement and preference clause and the consequences for violating them).

120. Emerson, *supra* note 110, at 347.

121. *Id.*

122. *Id.* The transferees usually try to obtain clauses where their funds are returned in the off chance that the franchisor disapproves due to the large risk they are taking, but these provisions are rare. *Id.*

D. *Brazil*

1. Business Formula

The governing franchise law in Brazil became effective in 1995.[123] It is the *Dispôe sobre o contrato de franquia empresarial e dá outras providências*, which provides for franchise business contracts and other franchise provisions.[124] This is a disclosure law and "does not contain provisions affecting the franchise relationship *per se*."[125] Article Two of the law defines a franchise as:

> A system whereby a [f]ranchisor licenses to the [f]ranchisee the right to use a trademark or patent, along with the right to distribute products or services on an exclusive or semi-exclusive basis and, possibly, also the right to use technology related to the establishment . . . of a business . . . developed or used by the [f]ranchisor, in exchange for direct or indirect compensation . . . .[126]

In Brazil, the law does not exempt any business relationship from the franchise definition.[127] Therefore, "partnership relationships, trademark licenses, wholesale distribution arrangements, and credit card services arrangements are not necessarily excluded from the scope of. . . [f]ranchise law."[128] Courts will prevent a franchisor from establishing a franchise branch in the same territory as a franchisee's business if the franchise agreement contains an exclusivity clause.[129]

The current law in Brazil does not require that the franchisor test the business formula before offering it for sale to a prospective franchisee.[130] However, Brazil may be moving towards requiring this testing of the business formula. In 2008, Bill No. 4.319/08[131] was proposed to require the franchisor to be in business at least twelve months prior to initiating a

123. Luiz Henrique O. Do Amaral et al., *Brazil*, *in* INTERNATIONAL FRANCHISE SALES LAWS 65, 68 (Andrew P. Loewinger & Michael K. Lindsey eds., 2d ed. 2015).

124. Lei No. 8.955, de 15 de Dezembro de 1994, COL. LEIS REP. FED. BRASIL, 186 (12, t. 2): 4813, Dezembro 1994 (Braz.).

125. Amaral et al., *supra* note 123, at 68.

126. *Id.*

127. *Id.* at 69.

128. *Id.*

129. Eduardo Grebler & Pedro Silveira Campos Soares, *Brazil*, *in* INTERNATIONAL FRANCHISING BRA/6 (Dennis Campbell ed., 2d ed. 2015) (analyzing the structure of franchising laws in Brazil).

130. Luciana Bassani, *Country Report Brazil: Franchising*, INT'L DISTRIBUTION INST. 6 (2013).

131. PL 4319/2008 *available at* http://www.camara.gov.br/proposicoesWeb/fichadetramitacao?idProposicao=416157 [https://perma.cc/BGE2-VJGL].

franchise.[132]

2. Goodwill[133]

There is no statute in Brazil "stating that franchisees have an interest in the franchise's goodwill."[134] However, Brazilian case law does recognize that tangible assets in the establishment belong to the franchisee.[135] But it is also unquestioned that the intellectual property belongs to the franchisor,[136] so many Brazilian courts have ruled that there are "no grounds for payment of any compensation to franchisees upon termination [or] non-renewal of their franchise agreements, as the franchisors were the owners of the most valuable intangible asset—the trademark—with its definitive power to attract clientele."[137] However, a recent court decision recognized the existence of local goodwill that is developed through the franchisee's efforts.[138] The court applied equity and unjust enrichment principles and awarded the franchisee half the value of the goodwill.[139] However, this is an isolated decision and is not how the majority of cases are decided.[140] Instead, courts typically evaluate a variety of factors, including, but not limited to, the following:

(i) the terms of the franchise agreement;
(ii) if the franchisor is the owner of a well-known trademark;
(iii) if the case involves a service franchise or a product franchise system;
(iv) if the franchise chain was started and developed in Brazil due to the particular efforts of a franchisee;

132. *Id.*

133. CÓDIGO CIVIL [C.C.][CIVIL CODE] art. 1142 (Braz.) (defining goodwill).

134. Luciana Bassani & Cândida Caffè, *Brazil: Compensation for Goodwill in Franchise Agreements,* 8 INT'L J. OF FRANCHISING L. 13, 13 (2010) (examining whether a franchisee is entitled to be compensated for goodwill if its agreement terminates or expires under Brazilian law).

135. Bassani & Caffè, *supra* note 134 (stating that establishment, or the place of business, is defined as consisting of "all tangible and intangible assets, duly organized in order to fulfill the company activities.").

136. CÓDIGO CIVIL [C.C.] [CIVIL CODE] art. 195 (Braz.), https://www.scribd.com/document/111028729/Brazilian-Industrial-Property-Law-Law-No-9279-96 [https://perma.cc/6W84-45PN] (defining unfair competition).

137. *Bassani &* Caffè, *supra* note 134, at 14; *see generally,* Katherine McGahee, *Update: Franchising in Brazil*, 20 LAW & BUS. REV. AM. 95, 95-105(2014) (discussing franchise fees for use of trademarks, importance of registration of trademarks and other intellectual property, and Brazil's membership in the Paris Convention, which, among other things, protects international marks).

138. Bassani & Caffè, *supra* note 134, at 14.

139. *Id.*

140. *Id.*

> (v) if the franchisee has prior experience in the franchise business; and
> (vi) if the franchisee independently attracts clientele due to its own efforts and not due to the particular elements of the franchise system, among other aspects.[141]

Brazilian franchise law mostly details disclosure and registration requirements for franchises.[142] Therefore, the franchise agreement itself is critical in determining key concepts of the franchise relationship. For example, it is common for parties to stipulate that the goodwill belongs solely to the franchisor.[143] McDonald's Latin America's contract with its Brazilian master franchisee, Arcos Dourados Comércio de Alimentos, has a specific provision that any enhancements, improvements, etc. are deemed the property of McDonald's as "'works made for hire' and shall constitute Intellectual Property hereunder."[144] However, in a situation where the technology or technical knowledge is unpatented and transferred, the know-how or technology "will belong to the licensee or franchisee at the expiration of the[] agreement."[145]

The element of exclusivity, such as when the franchise agreement guarantees exclusivity to a particular franchisee in a certain territory, may play a role in the court's decision.[146] If the franchisee has exclusive rights to a territory, it has a strong argument that any increase in the clientele was due to the franchisee's sole efforts and thus should be entitled to goodwill.[147]

However, there are still other elements in the franchise relationship that a court will consider, such as the oversight exercised by the franchisor. The more oversight the franchisor exercises, the more unlikely it becomes that a court will find that the franchisee has goodwill rights, since "any clientele resulting from this relationship clearly stems from the efforts of the know-

141. *Id.*

142. Cândida Ribeiro Caffé, *Franchising in Brazil,* INT'L FRANCHISE ASS'N, at 1 (Mar. 2008), *http://www.franchise.org/franchising-in-brazil* [https://perma.cc/93TF-BSSE] (summarizing current structure and procedural requirements of franchising law in Brazil).

143. Bassani & Caffé*, supra* note 134, at 15; *see also* McDonald's Latin America's Brazilian Master Franchise Agreement, SEC. & EXCH. COMM'N, § 7.4 (Jan. 9, 2009), http://www.sec.gov/Archives/edgar/data/1508478/000119312511077213/dex103.htm [https://perma.cc/83RH-UNCW] ("Brazilian Master Franchisee acknowledges and agrees . . . that the Intellectual Property and all rights therein and the goodwill pertaining thereto in Brazil belong to McDonald's . . . and that all uses of the Intellectual property in Brazil shall inure to and be for the benefit of McDonald's . . . .").

144. *Id.* at § 7.8.

145. Irecê de Azevedo Marques Trench et al., *Brazil*, *in* SURVEY OF FOREIGN LAWS AND REGULATIONS AFFECTING INTERNATIONAL FRANCHISING, Brazil-24 (Philip F. Zeidman ed., 2d ed. 1990) (outlining current Brazilian franchising law).

146. Bassani & Caffè, *supra* note 134, at 15.

147. *Id.*

how and operational methods stipulated by franchisor."[148]

To summarize, the provisions of the franchise contract are critical in determining whether the franchisee will be entitled to goodwill.[149] The degree of control exercised by the franchisor and the degree of exclusivity of a franchisee in a certain territory, along with other provisions in the franchise agreement, are critical in determining goodwill compensation.[150]

E. *Canada*

1. Business Formula

Presently, six of the ten Canadian provinces have enacted franchise-specification legislation.[151] Alberta enacted Canada's first franchise law, the Alberta Franchises Act, in 1972, which was modeled after California franchise legislation.[152] Since Alberta's enactment, Ontario, New Brunswick, Prince Edward Island, British Columbia, and Manitoba have also enacted franchise laws.[153] The most recent province to enact a franchise law was British Columbia, whose franchise legislation became effective in February 2017.[154]

In the Province of Ontario, the *Arthur Wishart Act (Franchise Disclosure)* (the Ontario Act) defines a franchise as "a right to engage in business" where a franchisee

"make[s] a payment or continuing payments . . . to the franchisor"; *and*

"the franchisor grants the franchisee the right to sell . . . or distribute goods or services that are *substantially* associated with the franchisor's . . . trade-mark, service mark, trade name, [etc.]" *and "*the franchisor . . . exercises *significant* control over, or . . .

148. *Id.*

149. *See supra* notes 123-34 and accompanying text.

150. Bassani & Caffè, *supra* note 134, at 15.

151. Brad Hanna, Les Chaiet & Jeffrey Levine, *Canada*, *in* INTERNATIONAL FRANCHISING CAN/1(Dennis Campbell ed., 2d ed. 2011).

152. Revised Statutes of Alberta, 2000, Chapter F-23; Franchises Act (the "Alberta Act").

153. Peter Snell, Larry Weinberg & Dominic Mochrie, *Canada*, *in* INTERNATIONAL FRANCHISE SALES LAWS 90 (Andrew P. Loewinger & Michael K. Lindsey eds., 2d ed. 2015); Chad Finkelstein, *Manitoba Introduces Franchise Law,* FINANCIAL POST (Apr. 10, 2012, 1:40 PM), http://business.financialpost.com/2012/04/10/manitoba-introduces-franchise-law/. The Franchises Act is available at http://web2.gov.mb.ca/laws/statutes/2010/c01310e.php.

154. *See* Tony Wilson, *New B.C. franchise rules offer more protection to franchisees*, THE GLOBE AND MAIL (Oct. 5, 2016, updated May 17, 2018), http://www.theglobeandmail.com/report-on-business/small-business/sb-managing/new-bc-franchise-rules-offer-more-protection-to-franchisees/article32263132/ [https://perma.cc/AYW6-37K2] (explaining that British Columbia is the sixth Canadian province to regulate the franchise industry in Canada and analyzing the potential implications of this regulation).

> assistance in, the franchisee's method of operation"; *or* the "franchisor . . . grants the franchisee the representational or distribution rights, whether or not a trade-mark . . . or other commercial symbol is involved, to sell . . . or distribute goods or services supplied by the franchisor" *and* "the franchisor . . . provides location assistance" (i.e., securing retail outlets, help with displays, etc.).[155]

Similarly, the *Franchise Act* (the Alberta Act)[156] in the province of Alberta defines franchises as granting a right to the franchisee to engage in business where the goods and services are substantially associated with a trademark, with significant control by the franchisor over business operations.[157] However, the Alberta statute requires the payment of a franchise initial fee, which is not a requirement under the Ontario Act.[158] This reason alone renders it possible for a business arrangement, including a distributorship, to be a franchise in Ontario, but not Alberta.[159]

The *Franchises Act*[160] in Prince Edward Island—created after the Ontario Act—is "almost identical" to the Ontario Act in defining a franchise.[161] Finally, the *Franchises Act*[162] in New Brunswick is also modeled after the Ontario Act and virtually identical to it.[163] It simply is not a requirement in any Canadian law for a franchisor to test a business model or run a franchise for a minimum amount of time before offering a franchise for sale.[164]

Applicable to the legislation in all provinces, Canadian law allows for the franchisor and franchisee to include an exclusivity provision in the franchise agreement.[165] In the absence of an exclusivity provision, there is

155. Arthur Wishart Act (Franchise Disclosure), S.O. 2000, c. 3, s. 1(1) (Can.) (emphasis added).

156. Franchises Act, R.S.A. 2000, c F-23, (Can.) https://www.canlii.org/en/ab/laws/stat/rsa-2000-c-f-23/latest/rsa-2000-c-f-23.html [https://perma.cc/TEV4-LB85].

157. Franchise Act, R.S.A. 2000, c. F-23(1(1)) (Can.).

158. *See* Snell, Weinberg & Mochrie, *supra* note 153, at 92 (stating that in Ontario there is no requirement that a franchise fee be paid).

159. *Id.*

160. Franchises Act, R.S.P.E.I.1988, c. F-14.1(1) (Can.).

161. *See* Snell, Weinberg & Mochrie, *supra* note 153, at 92 (stating that the Prince Edward Island Act is substantially similar in many ways to the Ontario Act.)

162. Franchises Act, S.N.B. 2007, c. F-23.5 (Can.).

163. *See* Snell, Weinberg & Mochrie, *supra* note 153, at 93 (writing that the New Brunswick Act is alike in both form and structure to the Ontario Act, and the Ontario and New Brunswick's definition of a franchise is "virtually identical").

164. Bruno Floriani & Marvin Liebman, *Canada*, *in* GETTING THE DEAL THROUGH: FRANCHISE 34, 37 (Philip F. Zeidman ed., 2014) http://www.franchise.org/sites/default/files/ek-pdfs/html_page/F2014-Canada_0.pdf [https://perma.cc/VZM3-YSSJ].

165. Frank Zaid & James Blackburn, *Country Report Canada: Franchising*, INT'L DISTRIBUTION INST. 14 (2014); Competition Act, R.S.C. 1985, c C-34 http://canlii.ca/t/52f4p

no prohibition on the franchisor from assigning other franchises to franchisees that will be in direct competition with the existing franchisees.[166]

2. Goodwill[167]

Goodwill compensation to a franchisee after termination of the franchise agreement is not recognized in Canada.[168] Typical Canadian franchising agreements include three main clauses dedicated to ensuring that the goodwill stays with the franchisor:

"franchisee should acknowledge that the franchisor is the owner of the trademark . . . the franchisee should be prohibited from registering in its own name any of the franchisor's trademarks,"[169]

"the franchisee acquires no right, title, or interest in and to the trademarks and all goodwill associated with the trade-marks enures to the benefit of the franchisor,"[170] and

the "franchisee agrees not to . . . dispute [] the ownership or enforceability of the trade-marks . . . ."[171]

Clauses suggesting that any goodwill associated with the trademarks "enures" (inures) to the sole benefit of the franchisor imply that Canada does not accept the concept of local goodwill or goodwill for the business as a going concern.

The fact that the franchisor has the right to bring suit in cases of trademark infringement further enforces the franchisor's ownership of the goodwill. In the event of trademark infringement, the franchisee has to request the franchisor to bring suit.[172] Only if the franchisor refuses or

[https://perma.cc/85NC-YQWL]; Exclusivity clauses are generally valid. Jacques Deslauriers, *Vente, louage, contrat d'entreprise ou de service*, para 1177 (Wilson et Lafleur, Montréal 2013).

166. Zaid & Blackburn, *supra* note 165.

167. Justice Thurlow interpreted the meaning of goodwill in the case of *Clairol Int'l Corp. v. Thomas Supply and Equip. Co. Ltd.*, 55 C.P.R. 176 (1968).

168. Frank Zaid & James Blackburn, *Country Report Canada: Franchising*, INT'L DISTRIBUTION INST. 18 (2014).

169. Daniel Ferguson & Ralph Kroman, *Canada*, *in* 1 INTERNATIONAL FRANCHISING CAN-76 (Dennis Campbell ed., 2001).

170. Darrell Jarvis & Edith Dover, *The Canadian Franchise Agreement*, *in* FUNDAMENTALS OF FRANCHISING - CANADA 182 (Peter Snell & Larry Weinberg eds., 2005).

171. *Id.*; *see also* G. Lee Muirhead, *Canadianizing Franchise Agreements,* 12 FRANCHISE L.J. 103, 106 (1993) ("Franchisees should acknowledge that they acquire no right, title or interest in the trademarks and that goodwill associated with the trademarks enures *exclusively* to the benefit of the franchisor.") (emphasis added)).

172. Judy Rost & Bruno Floriani, *Trademark and Other Intellectual Property Issues*, *in* FUNDAMENTALS OF FRANCHISING - CANADA 130 (Peter Snell & Larry Weinberg eds., 2005); Trade-marks Act, R.S.C., 1985, c. T-13(Section 19) ("Subject to sections 21, 32 and 67, the registration of a trade-mark in respect of any goods or services, unless shown to be invalid,

neglects to do so within two months can the franchisee file a claim for trademark infringement as if it were the owner.[173] Franchisors can easily avoid this situation by including a statement that the franchisor has "sole discretion to take any action it deems appropriate" in the franchise agreement.[174]

However, franchisors need to act cautiously as courts have awarded goodwill compensation to franchisees in recent cases. Termination of the franchise agreement signifies a loss of operating income for the franchisee.[175] Thus, on a theory of unjust enrichment, "meaning compensation for loss of the goodwill generated by the franchisee," franchisees have been able to recover for local goodwill.[176] Still, as long as "the franchisor had legal justification to terminate the franchise agreement, the franchisee will have no right to such compensation."[177]

The franchisor's exclusive ownership of the goodwill associated with the franchise's trademark brings about harsh consequences. Recently, the Quebec Superior Court held that Dunkin' Donuts, by failing to support the brand against competition, materially breached the franchise agreement.[178] The court awarded plaintiff-franchisees the sales they would have realized

gives to the owner of the trade-mark the exclusive right to the use throughout Canada of the trade-mark in respect of those goods or services.").

173. Rost & Floriani, *supra* note 172, at 130; Peter V. Snell, *Key Points in Advising Franchisors*, 3.1.7 (2010).

> When drafting trademark licensing provisions in the franchise agreement, the drafter should be aware of the rule set out in s. 50(3) of the *Trade-marks Act*. In the absence of an agreement to the contrary between the franchisor and the franchisee, the franchisee may force the franchisor to take proceedings for infringement of the licensed trademarks and, if the franchisor refuses or neglects to do so within two months after being so requested, the franchisee may institute proceedings for infringement in the franchisee's own name as if the franchisee were the owner, making the franchisor a defendant. In view of that provision, it is common in the franchise agreements to include a waiver by the franchisee of these rights.

Id.

174. Rost & Floriani, *supra* note 172, at 130.

175. Paul J. Bates, et al., *Canadian Franchise Disputes,* BATES BARRISTERS PROF. CORP. 9 (Dec. 2008), http://www.batesbarristers.com/FranchiseLawDisputes.pdf [https://perma.cc/MWY9-6K5D].

176. *Id.*

177. *Id.*

178. Jennifer Dolman et al., *Does a Franchisor Have an Obligation to Maintain Brand Strength?*, LEXOLOGY (June 28, 2012), http://www.lexology.com/library/detail.aspx?g=2ca218c3-2e35-40e3-8c52-de0b74fa1e88 [https://perma.cc/E6XM-WGJG] (summarizing the Quebec Superior Court's decision in *Bertico Inc. v. Dunkin' Brands Canada Ltd.*, [2012] C.S. 6439 (Can. Que.)); Christie Hall, *Dunkin' Donuts an Implied Duty on Franchisors to Enhance the Brand*, CANADIAN FRANCHISE (Sept. 4, 2015) http://www.canadianfranchisemagazine.com/expert-advice/dunkin-donuts-implied-duty-franchisors-enhance-brand/ [https://perma.cc/C866-MBAN].

had Dunkin' Donuts maintained its brand leadership in the market, plus compensation for the loss of the franchisees' investment.[179] In other words, failing to maintain the brand's high goodwill in the marketplace can result in a fundamental breach of contract, despite the franchisees' continuous use of the brand and their business being a going concern.[180]

F. *Australia*

1. Business Formula

The *Trade Practices (Industry Codes-Franchising) Regulations 1998* governs the Australian franchise agreement for obligations entered into before 2015.[181] The *Competition and Consumer* (*Industry Codes–Franchising*) *Regulation 2014*, known as the Franchising Code of Conduct (the Code), applies to all contracts agreed upon from January 1, 2015 onward.[182] The franchise agreement can be completely or partially written, oral or implied; all are acceptable forms of agreement under the Code.[183] In Australia, a franchise is a relationship where the agreement between the two parties grants to one party the right to offer, supply, or distribute goods or services under a system or marketing plan.[184] Other requirements of the franchising relationship include: the marketing plan is "substantially determined, controlled or suggested by the franchisor or an associate of the franchisor;"[185] the business must "be substantially or materially associated

179. Dolman et al., *supra* note 178.

180. *Id.*; Emerson, *supra* note 91, at 590-92 (discussing *Bertico*, *supra* notes 178-79 and accompanying text and, in contrast, an Ontario case, *Fairview Donut Inc. v. TDL Grp. Corp.*, 2012 CanLII 1252 (Can. Ont. Super. Ct.), and evaluating the need for franchisor know-how's steady transmission to the franchisees as part of their ongoing contractual relationship). A major reason for a franchise system's know-how – *savoir faire* – is the franchise parties' development and maintenance of goodwill.

181. Stephen Giles & Penny Ward, *Australia*, *in* INTERNATIONAL FRANCHISE SALES LAWS 1, 4 (Andrew P. Loewinger & Michael K. Lindsey eds., 2d ed. 2015).

182. *Id.*; AUSTRALIAN COMPETITION & CONSUMER COMMISSION, THE FRANCHISOR COMPLIANCE MANUAL 1 (Dec. 2014) ("The Franchising Code of Conduct is a mandatory industry code that applies to all of the parties to a franchise agreement.").

183. Giles & Ward, *supra* note 181, at 4. This law is also in the pre-2015 law. *Trade Practices* (*Industry Codes – Franchising*) *Regulations 1998* (Cth) § 4(1)(a) (Austl.).

184. Giles & Ward, *supra* note 181, at 4. This law is also in the pre-2015 law. *Trade Practices* (*Industry Codes – Franchising*) *Regulations 1998* (Cth) § 4(1)(b) (Austl.); *Competition and Consumer* (*Industry Codes — Franchising*) *Regulation 2014* (Cth) Select Legislative Instrument No. 168, 2014 (Austl.), https://www.legislation.gov.au/Details/F2014L01472 [https://perma.cc/K7CF-XDCF] (defining "franchise agreement" in Part 1, Division 2).

185. Giles & Ward, *supra* note 181, at 4. This law is also in the pre-2015 law. *Trade Practices* (*Industry Codes – Franchising*) *Regulations 1998* (Cth) § 4(1)(b) (Austl.).

with a trade mark, advertising or a commercial symbol . . . owned . . . by the franchisor;"[186] and "the franchisee must pay or agree to pay . . . an amount" that may include "an initial capital investment fee," a royalty fee, "a training fee," or other agreed upon fees.[187]

There is no franchisor or disclosure document *registration* requirement,[188] although a disclosure document is required as part of the franchise relationship under Section 6 of the Code.[189]

Australia's definition of a franchise agreement is very broad. It covers not only franchise arrangements, but also some forms of licensing and distribution arrangements, "particularly those that involve a system or marketing plan, as well as a right to use a trademark."[190] However, the following are *not* classified as franchise-type business relationships: (a) an employer-employee relationship; (b) a partnership; (c) a landlord-tenant relationship; (d) mortgagor-mortgagee relationship; (e) lender-borrower; and (f) relationships between the members of a cooperative that is formed by a commonwealth or state law.[191]

Any attempt to shape a franchise relationship into any of the listed relationships draws attention from the Commonwealth. The Code does not exempt other types of credit arrangements or wholesale distribution

186. Giles & Ward, *supra* note 181, at 4. This law is also in the pre-2015 law. *Trade Practices* (*Industry Codes – Franchising*) *Regulations 1998* (Cth) § 4(1)(c) (Austl.).

187. *Trade Practices* (*Industry Codes – Franchising*) *Regulations 1998* (Cth) § 4(1)(d)(i)–(iv) (Austl.).

188. Giles & Ward, *supra* note 181, at 5, 22.

189. *Trade Practices* (*Industry Codes – Franchising*) *Regulations 1998* (Cth) § 6 (Austl.); AUSTRALIAN COMPETITION & CONSUMER COMM'N, THE FRANCHISOR COMPLIANCE MANUAL: PRE-ENTRY DISCLOSURE AND COOLING OFF, http://www.accc.gov.au/publications/franchisor-compliance-manual/the-franchisor-compliance-manual/pre-entry-disclosure-and-cooling-off [https://perma.cc/73NN-NGZQ] (last visited Feb. 28, 2017).

> Under the Code, you must provide an information statement to a party who proposes to enter into a franchise agreement. You are also required to provide a disclosure document, franchise agreement and a copy of the Code to a party at least 14 days before they: enter into a franchise agreement (or an agreement to enter into a franchise agreement); pay any non-refundable money or other valuable consideration to you or an associate in connection with the franchise agreement; renew or extend their agreement.

Id.

190. Giles & Ward, *supra* note 181, at 6. *See* Lou Jones, Edward Levitt & Albrecht Schulz, *Inadvertent Franchise* 11 (26th Annual IBA/IFA Joint Conference - "Managing Risks in International Franchising") (May 18-19, 2010) (stating that, under the pre-2015 Australian franchise law, the Trade Practices (Industry Codes-Franchising) Regulations, "[t]he definition of 'franchise agreement' under the Code is broad and covers most arrangements involving the licensing of a name and operation of a business system.").

191. Giles & Ward, *supra* note 181, at 6. That is also the law under the pre-2015 Australian law. *Trade Practices* (*Industry Codes – Franchising*) *Regulations 1998* (Cth) § 4(3) (Austl.).

arrangements.[192] However, a wholesale distribution agreement will not fall under the franchise definition if the only payment required is for goods or services at their usual wholesale price,[193] as this would be a simple buyer-seller arrangement.

The Code is rendered inapplicable where the franchise agreement is (1) for goods or services substantially similar to those supplied by the franchisee "at least two years immediately before entering into the franchise agreement" and (2) the sales of those goods/services "are likely to provide" 20% or less of the franchisor's gross turnover for that class of goods in the first year.[194] Australia does not require testing of the franchise business model before an offer of sale is made to a perspective franchisee.[195]

In Australia, additional restrictions on franchise agreements relate to the availability of exclusivity provisions. Exclusivity provisions are subject to antitrust laws; initially, subject to the Trade Practices Act (TPA) of 1974, and currently subject to the Competition and Consumer Act (CCA) of 2010.[196] Under the CCA, a franchisor is prohibited from exclusive dealing. Exclusive dealing is found where the franchisor limits the franchisee to a territory and affects the franchisee's right to compete in the marketplace.[197] In determining whether exclusive dealing is occurring, the critical factor to evaluate is the length of the restriction; the longer, the more likely the restriction will become invalid.[198]

192. Giles & Ward, *supra* note 181, at 6. Again, that is also the law under the pre-2015 Australian law. *Trade Practices (Industry Codes – Franchising) Regulations 1998* (Cth) (Austl.).

193. Giles & Ward, *supra* note 181, at 6.

194. *Id.*

195. Philip Colman & John Sier, *Australia*, *in* GETTING THE DEAL THROUGH: FRANCHISE 5, 7 (Philip F. Zeidman ed., 2014), *available at* http://www.franchise.org/sites/default/files/ek-pdfs/html_page/F2014-Australia_0.pdf [https://perma.cc/K889-58SH]. This source suggested that as a practical matter, a prospective franchisor might not be very successful or attract any franchisees to engage in business relations unless they have some experience in franchising. *Id.*

196. AUSTRALIAN COMPETITION & CONSUMER COMM'N, EXCLUSIVE DEALING, *https://www.accc.gov.au/business/anti-competitive-behaviour/exclusive-dealing* [https://perma.cc/V9VD-PJ8H] (last visited Feb. 26, 2017).
Broadly speaking, exclusive dealing occurs when one person trading with another imposes some restrictions on the other's freedom to choose with whom, in what, or where they deal. Most types of exclusive dealing are against the law only when they substantially lessen competition, although some types are prohibited outright."). *Competition and Consumer Act 2010* (Cth) s 47 (Austl.), *available at* http://www.austlii.edu.au/au/legis/cth/consol_act/caca2010265/s47.html [https://perma.cc/28ZR-BUYT].

197. Carolyn Addie et al., *Australia*, *in* 1 INTERNATIONAL FRANCHISING Aus-54 (Dennis Campbell ed., 2001).

198. *Id.*

2. Goodwill

In *Federal Commissioner of Taxation v Murry*, the Federal Court of Australia defined goodwill as "the legal right or privilege to conduct a business in substantially the same manner and by substantially the same means that have attracted custom[ers] to it. It is a right or privilege that is inseparable from the conduct of the business."[199] Because goodwill is a derivative product of a recognized trademark, a particular location, or the reputation of the business, the federal court refused to define goodwill in terms of its elements, preferring instead to describe sources that contribute to goodwill.[200] These sources can be manufacturing or distribution techniques, efficient use of assets, good relationships with employees, lower prices that attract customers, etc.[201]

The court carefully distinguished the sources of goodwill from goodwill itself.[202] "Goodwill is an item of property and an asset in its own right. [I]t must be separated from those assets . . . that can be individually identified and quantified in the accounts of a business."[203] The court concluded that selling assets does not include the sale of goodwill unless the sale includes the right to conduct the business[204] in substantially the same manner and by substantially the same means "as has attracted custom[ers] to the business in the past."[205]

There are occasions when the sources of goodwill belong to a third party; for example, when the source is the premise from which a business

199. Commissioner of Taxation (Cth) v Murry [1998] HCA 42, ¶ 23 (Austl.) *available at* http://www.austlii.edu.au/cgi-bin/sinodisp/au/cases/cth/HCA/1998/42.html?query= [https://perma.cc/5684-YD4E]; Ian Tregoning, *FCT v Murry: The Federal Court Takes Licence with Goodwill*, 14 DEAKIN L. REV. 201 (1996), *available at* http://www.austlii.edu.au/au/journals/DeakinLawRw/1996/14.pdf [https://perma.cc/2WYE-7LVT].

200. Fed. Comm'r of Taxation v Murry (1997) 193 CLR 605, ¶ 24 (Austl.)

201. *Id.* ¶ 25. The Court does go on to describe other sources of goodwill, such as convenience of location or where a business chooses to spend its assets. *Id.* ¶¶ 26–28.

202. *Id.* ¶ 30.

203. *Id.*; *see also* Robert W. Emerson, *Franchises as Moral Rights*, 14 WAKE FOREST J. BUS. & INTELL. PROP. L. 540, 553 (citing MAREE SAINSBURY, MORAL RIGHTS AND THEIR APPLICATION IN AUSTRALIA 76 (2003) (noting that Australian law protects against "passing off," a type of misattribution tort claim where business goodwill, viewed as property, is injured by being passed off as the property of another)).

204. Fed. Comm'r of Taxation v Murry (1997) 193 CLR 605, ¶ 31 (Austl.).

205. *Id.* ¶ 45; *see also* Kristin Stammer & Irene Zeitler, *How Should Franchisors Deal with Goodwill?,* HERBERT SMITH FREEHILLS 1, 1 (Mar. 2, 2012), http://www.herbertsmithfreehills.com/-/media/Freehills/A02031218%2019.pdf. [https://perma.cc/6NKU-MKB8] (stating that, "[s]ince *Murry*, the proposition has been that goodwill is transferred only if there is a transfer of the legal right or privilege to conduct a business: in substantially the same manner, and by substantially the same means, as has attracted custom to the business in the past").

operates (such as when the premises are leased) or a brand/trademark.[206] Courts have found it difficult to classify goodwill in situations where sources of goodwill return to the franchisor after termination of the franchise agreement and the licensee's business becomes either nonexistent or can no longer continue in the same way.[207] The court will look at how the business is run to decide what course of action to take concerning goodwill.[208]

For example, in *BB Australia v Karioi*, the court determined that the goodwill remained with the franchisee.[209] Blockbuster granted Karioi, the franchisee, the right to use Blockbuster's methods of operations used in its existing video store.[210] Before it became a franchisee, Karioi had traded as a video rental store in the same locations and had substantial goodwill.[211] Because these "relevant sources of goodwill remained with the franchisee . . . the goodwill in the business at the end of the franchise arrangement" remained with them also.[212]

However, in Australia, a typical franchise agreement contains clauses stating that any "goodwill arising from use of the franchise system . . . belongs to the franchisor," that once the agreement is terminated the franchisee must return all franchisor-owned materials (such as brands, manuals, etc.), and that the franchisee cannot establish itself as a competitor to the franchise business upon termination of the franchise agreement.[213] The court will still look to the franchising relationship to determine ownership of goodwill, which means that franchisors should draft their contracts as explicitly as possible.[214] Certain situations that call for careful attention are when:

> a. [T]he franchise system is not one which seeks to dictate all elements of the way a franchisee operates,
> b. there are no obligations, or no obligations enforced by the franchisor requiring the franchisee to follow all aspects of a franchise system, and
> c. the franchisee operated an existing similar business, or holds the

206. Stammer & Zeitler, *supra* note 205.
207. *Id.* at 2.
208. *Id.*
209. *Id.*
210. BB Australia Pty Ltd v Karioi Pty Ltd [2010] NSWCA 347 ¶ 2 (Austl.).
211. *Id.* ¶ 34.
212. Stammer & Zeitler, *supra* note 205, at 2.
213. *Id.* at 3. A franchise contract written in favor of the franchisor could be held to be unconscionable, especially if the franchisor has superior bargaining power, as is most often the case. *See* Emerson, *supra* note 76, at 479 ("Australian courts have broad latitude in assessing all aspects of a contract or transaction to ensure fairness and prohibit unconscionable conduct on the part of the stronger party, which, at least in the franchise context, is most often the franchisor.").
214. Stammer & Zeitler, *supra* note 205, at 3.

lease, or other sources of goodwill used within its business.[215]

G. *Germany*

1. Business Formula

During the past decade and a half, franchising has been rapidly growing in the Federal Republic of Germany, but Germany has no specific legislation in place to govern the franchise relationship.[216] Thus, franchise agreements are governed by the contractual requirements in the German Civil Code and Commercial Code.[217] One of the earliest definitions of the franchise contract was introduced by the German Franchise Association and provides that "[t]he performance program of the franchisor. . . consists of a concept for purchase, distribution and organization, utilization of industrial property rights, the training of the franchisee and the obligation of the franchisor to support the franchisee actively and consistently and further to develop the concept."[218]

Germany does not have a mandatory legal requirement to test the

215. *Id.*

216. Marco Hero, *Country Report Germany: Franchising*, INT'L DISTRIBUTION INST. 1 (2015); *see also* Robert W. Emerson, *Franchising Constructive Termination: Quirk, Quagmire, or a French Solution?*, 18 U. PA. J. BUS. L. 163, 175 n.63 (2015) (noting that Germany has the third highest number of franchise networks in Europe at 910); Daniel Lindel, *Franchising: The Increasing Importance of Franchising in Germany*, GERMANY TRADE AND INVEST, http://www.gtai.de/GTAI/Navigation/EN/Invest/Industries/Consumer-industries/franchising.html [https://perma.cc/4L7G-QLTJ] (last visited Mar. 3, 2017).

> [The German franchising sector] has been growing more rapidly than the overall economy for years, and in 2015, it recorded gains of more than 4 percent. . . .
> • The turnover generated by the German franchising industry grew by 4.3% in 2015 to reach a total of EUR 99.2 billion.
> • In 2015, almost 1,000 franchisors operated in Germany.
> • Approximately 118,000 independent franchisees employed more than 686,000 people in 2015: an increase of more than 25% as compared to 2012.
> • In 2015, 39% of franchise systems in Germany were in the service sector, followed by retail with a share of 31%, food service and tourism with 20%, and skilled trades with 8%.

Id.

217. Hero, *supra* note 216, at 1-2. In Germany, there are no specific laws regulating franchising. Therefore, the legal framework for the offer and sale of franchises is governed only by the general provisions of contract law (German Civil Code) (Bürgerliches Gesetzbuch) (BGB), consumer law, commercial law (the Commercial Code), competition law, and unfair trade law. Karsten Metzlaff, *Franchising in Germany: Overview*, PRAC. LAW (last updated Sept. 1, 2016), http://uk.practicallaw.com/4-633-5269#a959851 [https://perma.cc/WR75-A6Y3].

218. Stefan Bretthauer, *Germany, in* INTERNATIONAL FRANCHISING GER/4 (Dennis Campbell ed., 2d ed. 2017).

franchising formula before offering it for sale.[219] However, the German Franchise Association does list "principles" in its Code of Ethics that must be applied in order to become and remain a member.[220] These principles include (1) running a successful business concept for a reasonable time period and with at least one pilot project before someone tries selling that model as a franchise; (2) owning or legitimately using the company name, trademark or other special labeling; and (3) conducting initial training of the franchisee as well as assuring ongoing commercial/technical support.[221]

In Germany, statutes favor the franchisee, as is suggested by its usage of agency law principles. "The franchisee is pursuing the aim of running a system business and earning revenues."[222] The law sees the franchisor's role as supportive of this goal.[223] Therefore, protecting the franchisee from competition becomes part of the franchisor's legal obligations under the agreement.[224] However, the obligation only arises if the franchisee's financial existence is jeopardized in the long term due to other franchisees competing in the territory.[225]

German contracts often contain similar protections of the franchisee that are seen in other countries.[226] The franchisor cannot grant licenses to other franchisees in the territory,[227] the franchisor itself cannot compete

219. Karsten Metzlaff & Tom Billig, *Germany*, *in* GETTING THE DEAL THROUGH: FRANCHISE 69, 70 (Philip F. Zeidman ed., 2014).

220. *Id.*

221. *Id.*

222. Hero, *supra* note 216, at 9.

223. *Id.*; *see also* Emerson, *supra* note 91, at 619 n.183 (noting the obligation of franchisors to grant know-how to franchisees).

224. Hero, *supra* note 216216, at 9.

225. *Id.*

226. Marco Hero, *Germany*, *in* FUNDAMENTALS OF FRANCHISING: EUROPE 183, 193-196 (Robert A. Laurer & John Pratt eds. 2017) (discussing how any number of laws found in Germany lead to the crafting of franchise agreements with protections for the franchisee – compliance with consumer protection laws, recognition of the statutory restrictions on non-compete covenants and on disclaimers about fraud, clauses on social security, data protection, and antitrust matters, and commonly granted franchisee exclusive territories); *see* Emerson, *supra* note 91, at 614 n.148 (noting German contract law generally governs franchising, and German franchise contracts must be written in accordance with specific rules).

227. *See* Karl Rauser & Karsten Metzlaff, *Can Sub-franchise Continue once Master Franchise Agreement is Revoked?*, INTERNATIONAL LAW OFFICE (Jan. 15, 2013).

> It was irrelevant that the case involved an exclusive sub-licence for Germany and Austria. While this naturally restricts the right of the main licensee considerably because it cannot grant any other licence for that territory, the main licensor must accept this restriction because it consented to the main licensee granting exclusive sub-licences. Therefore, the main licensor must accept that its exclusive right of use is restricted by the exclusive rights of use granted to the sub-licensee.

Id.

directly in the territory,[228] and the franchisor must prohibit all franchisees from selling directly in the territory.[229] However, the franchisor can reserve its right to compete in the territory on a particular brand or product line.[230] Care should be taken to define exclusivity clearly in the agreement, as courts will imply exclusivity rights into franchise agreements under the rationale that the franchisee's business success is an aim of both parties under the agreement.[231]

2. Goodwill

Under agency principles in the commercial code,[232] Germany recognizes compensation for goodwill upon termination of the franchise contract.[233] To obtain compensation under the German code, the agent (franchisee) has to prove that: (1) the principal (franchisor) enjoys substantial benefit from clientele (in other words the goodwill) that the franchisee has accumulated even after termination of the contract; (2) the franchisee lost his right to commission on future sales or those recently transacted because of the termination of the contract; and (3) the payment is equitable under the circumstances.[234] Under these laws, some franchisors in Germany "have had to pay up to one year's revenue in goodwill compensation upon termination to certain franchisees."[235] If goodwill indemnity is provided, the

228. Thomas Salomon & Michael Dettmeier, *Franchising Country Questions: Germany,* PRAC. LAW (last updated July 5, 2013), http://us.practicallaw.com/6-102-2116 [https://perma.cc/GGE2-SNHD] (noting that the German Act Against Restrictions on Competition covers contractual territories – in effect, to franchises – and that territorial restrictions thus are allowed when they do not affect trade between European Union (EU) member states; further citing Article 4 of the EU Block Exemption Regulation on *Vertical Restraints* and therefore further stating, "[A]n agreement that the franchisee must not sell in territories where he would be a competitor of the franchisor or other franchisees will only be permissible if the franchisee remains free to passively sell into such territories.").

229. Hero, *supra* note 216, at 10.

230. *Id.*

231. *Id.*

232. HANDELSGESETZBUCH [HGB] [Commercial Code], May 10, 1897, BAUMBACH-DUDEN 252 (Ger.), *translated in* THE GERMAN COMMERCIAL CODE 31–32 (Simon L. Goren trans., 2d ed., 1998).

233. Rolf Trittmann, *Germany*, *in* 1 INTERNATIONAL AGENCY AND DISTRIBUTION LAW Ger-16 (2d ed., Dennis Campbell ed., 2017).

234. THE GERMAN COMMERCIAL CODE 31–32 (Simon L. Goren trans., 2d ed., 1998). *See also* Trittmann*, supra* note 233, at Ger-35, 36 (explaining that the first element, whether the franchisor can obtain sufficient benefit from the goodwill (clientele) that the franchisee created, is determined by presuming that the clientele will continue to conduct business with the franchisor after termination of the contract, even if they do not).

235. Chris Wormald, *Germany: Agency Compensation Denied,* FIELDFISHER (Jan. 27, 2012), http://www.fieldfisher.com/publications/2012/01/franflash-compensation-upon-termination#sthash.Byc5LQBN.dpbs [https://perma.cc/4F5S-8KSR].

distributor/franchisee also should receive it upon termination the same as for an agent; while the calculations vary from court to court, the amounts are calculated "based on the distributor's margin made in the last year with new customers brought by the distributor or with existing customers where the distributor has significantly increased the business."[236]

However, this trend of awarding goodwill compensation to franchisees may change soon. In a recent decision, a regional court in Mönchengladbach[237] rejected a franchisee's claim for goodwill.[238] The case involved a bakery franchisee that sued for goodwill compensation when the franchisor terminated the franchising contract.[239] The court was explicit in stating that there is no compensation for goodwill unless the contract specifically calls for the transfer of the customer base.[240] The ramifications of this remain to be seen, but "[f]or the time being, franchisors should not include a contractual obligation to transfer the customer base in the franchise agreement for Germany."[241]

A franchisee may also be able to recover under Section 89b of the Commercial Code (compensation claim of a commercial agent after ending of the contract).[242] This compensation is only awarded if two conditions are met: (1) the franchisee has been integrated in the sales organization of the franchisor in a manner similar to that of a commercial agent; and (2) there exists a contractual obligation to transfer the customer base.[243] For the first factor, the existence of non-compete or exclusivity provisions is a strong indicator of the franchisee's integration into the system.[244] As most franchise

236. Benedikt Rohrssen, *"German" Distributor Indemnity – How to avoid it*, LEGALMONDO (Nov. 21, 2016), https://www.legalmondo.com/2016/11/german-distributor-indemnity-avoid/ [https://perma.cc/X8P3-QRL8].

237. Mönchengladbach, Germany is located west of the Rhine, between Düsseldorf and the Dutch border.

238. Wormald, *supra* note 235.

239. *Id.*

240. *Id.*

241. *Id.*

242. *See* Karsten Metzlaff & Karl Rauser, *De facto retention of customer base establishes no Section 89b claim*, INTERNATIONAL LAW OFFICE (May 31, 2011); *see also* Karsten Metzlaff & Karl Rauser, *Compensation of Franchisee upon Termination of the Franchise Agreement*, INTERNATIONAL LAW OFFICE (July 6, 2004) ("Section 89b of the German Commercial Code entitles a commercial agent to compensation upon termination of the contract, since throughout the duration of the contract, the agent builds up an established clientele which the principal can continue to use.").

243. Metzlaff & Rauser, *De facto retention of customer base establishes no Section 89b claim*, *supra* note 242; Bernd Westphal & Peter Zickenheiner, *The Goodwill Indemnity in Agency Contracts and in Distribution Contracts in Germany: When Has to be Paid and How Has to be Calculated*, http://images.to.camcom.it/f/ EICConvegni /28/28783_CCIAAT O_2992015.pdf.

244. Karsten Metzlaff, *Germany – Franchisee's Claim for Compensation upon*

agreements contain one – if not both – of these clauses, typically there is no dispute that the franchisee is integrated in the franchise system.[245] The most significant barrier to this Section's application is that most franchise agreements do not provide a customer retention clause in their contract. For the franchisor, this legislative requirement usually bars franchisee recovery for *de facto* retention that occurs at the end of the franchise relationship, however, that is not always the case. A few franchisees have successfully established entitlement to compensation under this section notwithstanding the absence of such a clause when the franchisor was provided the names and addresses of the franchisee's clientele at the termination of the relationship.[246]

H. *India*

1. Business Formula

India does not currently have franchise-specific legislation enacted.[247] Thus, India's Contract Act of 1872 governs franchise agreements. Chapter 5 of the Finance Act of 1999 does provide that a "franchise" is "an agreement by which the franchisee is granted representational rights to sell or manufacture goods or to provide service or undertake any process identified with franchisor, whether or not a trade mark, service mark, trade name or logo . . . is involved."[248] With no franchise-specific laws, India does not have a testing requirement where the franchisor must test the business formula before offering it for sale to the franchisee.[249]

The parties to a franchise agreement are not precluded from contracting

Termination, 5 INT'L J. FRANCHISING LAW 8 (2007).

245. *Id.*

246. Metzlaff & Rauser, *Compensation of Franchisee upon Termination of the Franchise Agreement*, *supra* note 242 ("The decisive aspect for the court was whether the franchisor could make immediate use of the established clientele without further ado once the contract had terminated.").

247. Srijoy Das, *Franchising in India*, INT'L FRANCHISE LAWYERS ASS'N (Oct. 29, 2017) ("There is no specific legislation regulating franchise arrangements in India."); Saurabh Misra, *Country Report India: Franchising*, INT'L DISTRIBUTION INST. 6 (last updated Jan. 2015); Philip F. Zeidman & Abhishek Dube, *How India's Investment Laws Affect Franchisors*, FRANCHISE TIMES (Apr. 27, 2017), http://www.franchisetimes.com/May-2015/How-Indias-investment-laws-affect-franchisors/ [https://perma.cc/89L6-BSJS].

248. Misra, *supra* note 247, at 1.

249. *Id.*; Preeti G. Mehta, *Franchising in India: Overview*, PRACTICAL LAW COUNTRY Q&A 5-630-8133 (2016) (Law as of July 1, 2016), Westlaw, *http://us.practicallaw.com/5-630-8133* ("There is currently no legislation specifically regulating franchising or granting protection to local agents in India. In the absence of specific legislation, the offer and sale of franchises in India is governed by a variety of statutes, rules and regulations . . . .").

for exclusivity provisions by Indian law.[250] The burden of proof is on the franchisee to prove beyond a reasonable doubt that it had exclusivity rights.[251] Without such a clause, the franchisor is free to directly compete with the franchisee in any territory.[252] Although case law is sparse as to how courts treat a franchisor's violation of an exclusivity clause, Indian courts may rule in favor of the franchisee on good faith or breach of contract grounds.[253]

2. Goodwill

India does not statutorily recognize goodwill compensation to the franchisee, but courts are willing to award goodwill compensation when it is reasonable.[254] This equitable application of law can be seen in a related topic: know-how licensing. In *In re Sarabhai M. Chemicals Pvt. Ltd. v. Unknown*, the Monopolies and Restrictive Trade Practices Commission (the MRTPC) held against a know-how clause between a German and Indian pharmaceutical franchise that did not allow the Indian franchisee to sell, package, or manufacture any of the licensed products for twenty years.[255] The commission found that because medicine was acutely scarce and so vital to national health, this clause was against the national interest of India.[256] The franchisee received the actual ownership of the merchandise it was licensed to sell.[257]

Any goodwill the franchisee obtains would presumably have to be bought by the franchisor in the event the franchisor wants to terminate the franchise contract, since the franchisee essentially owns it. It is unclear if this is the law in India generally or only in areas where the country has a strong public interest.

250. Misra, *supra* note 247, at 6 (§ 8).

251. *Id.*

252. *Id.*

253. *Id.*

254. *Id.* at 10 (§ 14).

255. *In Re: Sarabhai M. Chems. Pvt. Ltd. v. Unknown*, 1979 49 CompCas 145 NULL (1978) *https://indiankanoon.org/doc/199164/* [https://perma.cc/9NX5-NECQ].

256. *Id.*

> It is and has been such that there has been acute scarcity of some of these pharmaceuticals and chemicals, so vital for the health of our nation. In imposing a negative covenant of this kind on the second respondent it is obvious that the first respondent was actuated by purely private interest, an interest which completely conflicted with and was detrimental to the national interest.

Id.

257. *Id.*

I. *Japan*

1. Business Formula

Japan does not have one uniform definition of what constitutes a franchise.[258] Instead, there are three relevant definitions. The Medium-Small Retail Promotion Act (MSRPA) defines a "qualified chain-store business" as "a business in which, according to a standard contract, goods are continually sold, directly or by a designated third party, and assistance over the operation is continually given, principally to medium or small sized retailers."[259] The Act also defines a "specified chain business," which encompasses a business's use of trademarks, trade names, etc.[260] The Antimonopoly Act (the Act on Prohibition of Private Monopolisation and Maintenance of Fair Trade – Act No. 54 of 1947) notes that franchises can be defined by multiple definitions, but states that generally a franchise is "a form of business in which the head office provides the member with the rights to use a specific trademark and trade name, and provides coordinated control, guidance, and support for the member's business and its management."[261] The Japan Fair Trade Commission regulates the

258. Kenichi Sadaka & Aoi Inoue, *Japan*, *in* THE INTERNATIONAL COMPARATIVE LEGAL GUIDE TO: FRANCHISE 2016 87, 87 (2d ed. 2016), https://www.amt-law.com/res/news_2015_pdf/151210_4659.pdf [https://perma.cc/V4JG-5BCS] (sharing insight on Japanese franchise law by lawyers from the Japan-based law firm of Anderson Mori & Tomotsune).

259. Souichirou Kozuka & Jun Kanda, *Country Report Japan: Franchising*, INT'L DISTRIBUTION INST. Q.1 (last updated June 2011).

> The Medium and Small Retail Commerce Promotion Act (Law No. 110 of 1973) (MSRCPA) regulates franchising that falls under the definition of "specified chain business." A "chain business" is defined as a business that, under an agreement with standard terms and conditions, continuously sells or acts as an agent for sales of products and provides guidance regarding management, primarily targeting medium and small retailers (Article 3, paragraph 5, MSRCPA). A "specified chain business" is defined as any chain business where a member (Article 11, paragraph 1, MSRCPA):
>
> • Is allowed to use certain trademarks, trade names or any other signs.
>
> • Must pay joining fees, deposits or any other monies on becoming a member.
>
> Apart from the MSRCPA and the Guidelines concerning the Franchise System under the Anti-Monopoly Act, there is no law that specifically regulates franchising. There are, however, many laws that regulate specific industries or businesses, which may also apply to franchises. The franchisor must therefore comply with the applicable laws and regulations.

Etsuko Hara, *Franchising in Japan: Overview*, PRACTICAL LAW COUNTRY Q&A *4-632-3469 (2017)* (Law as of June 30, 2017), Westlaw, http://us.practicallaw.com/4-632-3469 [https://perma.cc/K7XJ-LVQW].

260. Hara, *supra* note 259.

261. JAPAN FAIR TRADE COMM'N, GUIDELINES CONCERNING THE FRANCHISE SYSTEM

enforcement of the Antimonopoly Act and issued guidelines on franchising in 2002.[262] The Japan Franchise Association (JFA) defines a franchise as:

> [A] continuing relationship between one business concern (called a Franchisor) and another business concern (called a Franchisee) where a Franchis[o]r and a Franchisee enter into a contractual agreement, the Franchis[o]r granting the Franchisee the right to use the signs representing the Franchisor's business . . . the Franchisee paying the consideration to the Franchisor in return . . . .[263]

Courts most frequently cite JFA's definition, which is narrower than the MSRCPA definition. Furthermore, franchisors have no obligation to test their business formula before offering it to a franchisee in Japan.[264]

In 2000, the Kagoshima District Court ruled that exclusivity was inherent in the term "territory."[265] This case involved a master franchise agreement that did not explicitly include an exclusivity provision.[266] The court determined that the franchisee is entitled to exclusivity in Japan and the contract does not need to provide for that in order for exclusivity to apply.[267] The franchisor's main obligation in Japanese exclusivity clauses is to refrain from conducting business in the franchisee's territory.[268]

2. Goodwill

On the topic of goodwill, it is not so clear-cut. One case applying distributorship law awarded goodwill compensation (in an amount equal to lost profits) to the distributor on a finding "that the distributor contributed to

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UNDER THE ANTIMONOPOLY ACT, (April 24. 2002), http://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines.files/franchise.pdf [https://perma.cc/3Z64-6LZ3].

> The franchise system is defined in many ways. However, the franchise system is generally considered to be a form of business in which the head office provides the member with the rights to use a specific trademark and trade name, and provides coordinated control, guidance, and support for the member's business and its management. The head office may provide support in relation to the selling of commodities and the provision of services. In return, the member pays the head office. This document is intended for businesses that fit this definition and that have the characteristics mentioned (3) below, irrespective of what the business is called.

Id.; *see also* Kozuka & Kanda, *supra* note 259.

262. Kozuka & Kanda, *supra* note 259; JAPAN FAIR TRADE COMM'N, supra note 261.

263. *JFA's Definition of Franchise*, JAPAN FRANCHISE ASS'N, http://www.jfa-fc.or.jp/particle /111.html [https://perma.cc/Q43B-D6NG] *(last visited Nov. 4, 2017).*

264. Kozuka & Kanda, *supra* note 259, at n.4.

265. *Id.* at n.8.1.

266. *Id.*

267. *Id.*

268. *Id.* at n.8.2.

the establishment of a market for the item in the territory" and could reasonably expect to receive one year's profits from those efforts.[269] The contract had no definitive term and the franchisor canceled only because there was a recent slow-down in the distributor's activities.[270] In general however, this sort of goodwill compensation is not awarded to the franchisees.[271] With Japanese case law, it seems as if as long as the termination of the franchise contract is valid, the franchisee will not be able to request goodwill compensation from the franchisor.

J. *United Kingdom*

1. Business Formula

In an effort to avoid regulating business activities, the United Kingdom (UK) has no legislative provisions governing franchising. Thus, general contract law is applied to franchise agreements.[272] UK franchise agreements are typically modeled in compliance with the British Franchise Association's (BFA) Code of Ethics, which is a slight variation on the European Franchise Federation's Code.[273] There is also no legal, statutory, or common-law requirement to test the business formula.[274] However, in order to be a member of the British Franchise Association, prospective franchisors need to meet the following requirements:

"[T]o have operated at least one pilot business on an arm's-length basis before starting to franchise;"[275]

Have the legal rights or ownership of the franchise network's trademark, trade name, etc.;[276] and

Provide the franchisee with initial training, and other assistance during

269. Takeshi Kikuchi, *Agency and Distribution Agreements in Japan*, *in* 3 INT'L AGENCY AND DISTRIBUTION AGREEMENTS: ANALYSIS & FORMS § 2.11.2 (2011).

270. *Id.*

271. *Id. See also* Kozuka & Kanda, *supra* note 259, at n.14 (stating that neither Japan's statutory rules nor case law admits goodwill compensation to the franchisee as long as the contract is validly terminated).

272. John Pratt, *Country Report UK: Franchising*, INT'L DISTRIBUTION INST. Q.1, (last updated Oct. 2015).

273. *Id.* at n.1.

274. *Id.* at n.4.

275. Gurmeet S. Jakhu, *United Kingdom*, *in* GETTING THE DEAL THROUGH: FRANCHISE, 186 (Philip F. Zeidman ed., 2014); Pratt, *supra* note 272, at n. 4 ("The Franchisor shall have operated a business concept with success for a reasonable time and in at least one pilot unit before starting its franchise network."). A company-owned unit can be sufficient to meet the "one pilot unit" requirement. In order to do so, the pilot must be operated by a manager who remains distant from the actual business in order to test the system and infrastructure. *Id*.

276. *Id*.

the contract period.[277]

The franchisee is not entitled to any implied rights to exclusivity absent a clause granting it.[278] English laws distinguish between granting exclusive rights "whereby the franchisor is prevented from granting any other rights to third parties and from itself" operating within the protected territory and sole rights which prevent the franchisor from granting others the right to operate in the territory, but do not exclude the franchisor from doing so.[279] The specific language of the agreements will determine which of these two rights was granted.[280]

2. Goodwill

The UK has had no cases where franchisees have been entitled to a goodwill indemnity.[281] An English court might classify a franchisee as a commercial agent and apply the Commercial Agents Regulations,[282] which recognize an agent's claim for compensation in the actual business (local goodwill).[283] However, in practice, this argument is unlikely to convince

277. *Id.*; *see generally European Code of Ethics for Franchising*, BRITISH FRANCHISE ASS'N, http://www.thebfa.org/about-bfa/code-of-ethics [https://perma.cc/7T7U-9FPF] (listing requirements of a franchisor under the European Code of Ethics).

278. Pratt, *supra* note 272, at n.8.

279. *Id.*

280. *Id.*; *Franchising: The Legal Considerations,* WRIGHT, JOHNSTON & MACKENZIE LLP, http://www.wjm.co.uk/images/uploads/2012_Franchising_-_The_Legal_Consideratio ns_.pdf [https://perma.cc/J2ZM-MMSP] (last visited Feb. 26, 2017). It is not the case that every franchise will confer an exclusive territory on the franchisee. However, where exclusivity is to be granted it is very important that the word 'exclusive' is used in preference to the word 'sole'. This is not purely a matter of legal terminology; the words simply mean different things." As further declared, "[i]f a party is appointed the 'sole' franchisee in an area, it would be interpreted to mean that while the franchisor would not appoint any other franchisees in that area, the franchisor is not prevented from opening company owned outlets." Noting, as well, "[o]n the other hand, 'exclusive' means that the franchisee will be protected from competition both from the franchisor itself and from other franchisees appointed by the franchisor. In other words, the franchisor is completely locked-out of the area.

281. Pratt, *supra* note 272, at Q.14; International Bar Association Legal Practice Division, *International Sales*, 24 INTERNATIONAL SALES COMMITTEE NEWSLETTER, September 2007, at 28 ("There is no legal basis on which distributors can claim goodwill compensation under either UK common law, or UK legislation. The English Court of Appeal (CoA) has held that the European Commission Commercial Agents Directive ('Directive 86/653') does not apply to distributors. English law does not permit Directive 86/653 to be applied by analogy to justify awarding goodwill compensation to distributors. . .") (case citations omitted).

282. Pratt, *supra* note 272.

283. Mark Abell & David Bond, *England and Wales*, *in* INTERNATIONAL AGENCY AND DISTRIBUTION LAW ENG-18-20 (Dennis Campbell ed., 2001); *Advantages and Disadvantages*, ENTERPRISE EUROPEAN NETWORK SCOTLAND, http://www.enterprise-europe-scotland.com/sct/services/Advantages_and_disadvantages_.asp?savemsg=-1

English courts.[284]

K. *Other National Perspectives*

Some other countries' perspectives must be noted. In a recent decision in Greece, the court decided to award compensation to the franchisee not because of franchise goodwill, but due to the expenses the franchisee must have incurred to conserve the franchisor's stock after the termination of the franchise relationship.[285] Interestingly, the court's considerations of the franchisee's expenses stemmed from the principle that a franchisor must terminate its contractual relationship with the franchisee in a way to protect the franchisee from disadvantages – implying a good faith requirement.[286] However, in Italy, a franchisor will not be required to buy back or indemnify the franchisee for stock or equipment left with the franchisee after termination, where the franchise contract provides the franchisor with merely an option to repurchase, which was validly exercised.[287]

[https://perma.cc/9WS4-CW5G] (last visited Nov. 17, 2017) ("Principals need to take the possibility of goodwill compensation into account when a contract is terminated.").

284. Pratt, *supra* note 272, at Q.14. As noted by prominent English legal practitioners, commercial agents, who may constitute franchisees, retain goodwill in their own business (presumably what they provided as part of the agency), but not in the principal's goods or services, and the agent therefore has no entitlement to compensation related to the latter's goods or services. Abell & Bond, *supra* note 283, at ENG-21.

285. S. Yanakakis A. Kalogeropoulou Law Offices, *Landmark case sets out franchisors' post-contractual obligations*, INT'L L. OFF. (March 29, 2011), http://www.internationallawoffice.com/Newsletters/Franchising/Greece/S-Yanakakis-A-Kalogeropoulou-Law-Offices/Landmark-case-sets-out-franchisors-post-contractual-obligations [https://perma.cc/5QE2-B5HF]. *See also* Mark Abell, *Post-Termination Non-Competes in the European Union*, THE FRANCHISE LAW., http://www.americanbar.org/publications/franchise_lawyer/2013/fall_2013/ post_termination_non_compete_in_europea_union.html [https:// perma.cc/F2NL-8KMC] *(last visited Nov. 17, 2017)* ("In Greece, after the expiration or termination of a franchise agreement, the franchisee may no longer take advantage of the franchise system, *see* Section 719, Greek Civil Code, and the franchisee's freedom to compete is subject to Greek law on unfair competition, *see* Article 919, Greek Civil Code; Law 146/14 on Unfair Competition. Covenants not to compete are prima facie valid unless they are contrary to public policy. *See* Article 178, Greek Civil Code. Greek courts will enforce non-compete provisions as long as they are considered reasonable and in accordance with general principles of law, such as good faith, ethical conduct, and protection from abuse of rights. Because there is no definition of what is 'reasonable' in this context, courts will determine reasonableness on a case-by-case basis. As long as a covenant not to compete is of limited duration and applies only to a specific restricted territory, it should be valid under Greek law. *See* F.I.C. of Athens 11486/80 JCL (1981) 50,131, F.I.C. of Athens 14284/81, JCL (1982) 144, F.I.C. of Heraklion 158/86, JCL (1987) 3 Heraklion 158/86, JCL (1987) 38.").

286. *See* S. Yanakakis A. Kalogeropoulou Law Offices, *supra* note 285. ("It is not in the franchisor's interests to leave it to the ex-franchisee to sell the remaining franchise products, since the reputation and credibility of the franchising network may be affected.").

287. Rinaldi e Associati, *Buying back franchisees' equipment: an obligation or a right?*,

In Spain, franchisee recovery is not thought of in terms of franchisee goodwill compensation, but instead is viewed as "indemnity for loss of clientele." This indemnity is awarded in fixed period contracts in which (i) there has been an abusive termination of the contract, or (ii) the contract was terminated correctly, but the parties never discussed the issue of indemnity and the franchisor will continue doing business with the franchisee's clientele.[288] However, this indemnity for clientele can be limited or barred if the parties' contract expressly prohibits this indemnity.[289]

II. CONCLUSIONS AND PROPOSALS

The international marketplace favors franchising as a source of foreign investment that nonetheless creates local entrepreneurship. Issues such as goodwill compensation and the testing of the business model are critical in understanding franchising worldwide. Governance of these issues is not only important for the parties involved, but also essential for protecting the U.S. and world economies. Franchising is a vital, growing sector of the domestic and global market. For instance, franchises in the United States generate 10% of all U.S. jobs and contribute more than $2 trillion to the

INT'L L. OFF. (Aug. 2, 2011). *See also* Roberto Pera & Irene Morgillo, *Italy*, GETTING THE DEAL THROUGH: FRANCHISE (2016), https://www.franchise.org/sites/default/files/uploaded_documents/F2016%20Italy.pdf [https://perma.cc/2QS8-NDD3].

> Similarly to termination by the franchisor, the franchisee may terminate in the case of default or non-performance of the contract terms by the franchisor. The breach must be serious, such as the franchisor unreasonably suspending the supply of goods to the franchisee. If the franchisee terminates the agreement, it is also entitled to the reimbursement of initial fees and costs, damages, or both. In practice, due to the extreme difficulties of proving and quantifying damages, franchise agreements usually grant the right for the franchisee to be reimbursed the entrance fee, if any, or an obligation for the franchisor to repurchase the franchisee's stock. However, a typical franchise agreement may include a penalty fee in favour of the franchisor if the franchisee terminates the agreement without reasonable cause.

Id.

288. *See* Alberto Echarri, *Compensation or Profit?*, INT'L L. OFF. (May 8, 2001), http://www.internationallawoffice.com/Newsletters/Franchising/Spain/Mullerat/Compensation-or-Profit?l=7U3P1XT [https://perma.cc/62FD-E274] (stating how franchisees in Spain have a legally guaranteed right to protection of their clientele upon termination of the franchise); *Franchise in Spain*, JAUSAS, http://www.jausaslegal.com/resources/doc/070816-franchise-65260.pdf [https://perma.cc/7E5Z-TSMX] (last visited Nov. 17, 2017).

> It is necessary to clearly spell out in the contract who is entitled to the goodwill. Upon termination of the contract, especially when it has come about as the result of a breach, there is the possibility of damages claims by the former franchisee, against the franchiser or the new franchisee, as regards the clientele.

Id.

289. Echarri, *supra* note 288.

economy each year.[290] In 2016, U.S. franchised businesses operated over 800,000 establishments, including franchisee-owned and franchisor-owned establishments.[291] Moreover, in certain American market sectors, such as restaurants, lodging, and retail sales generally, franchising represents an exceptionally large portion of the economy.[292] In fact, the enormous economic impact of franchising has been felt worldwide. As concluded in a 2016 study, "[w]ith its long history of success, franchising is a global success story where economies from all over the world have benefitted from the franchise model."[293] All twelve nations examined in-depth for that study (Argentina, Australia, Brazil, Canada, China, Colombia, India, Indonesia, Mexico, South Africa, United Kingdom, and Vietnam) showed rapid progress, typically far outpacing economic growth generally. To take one key example, in 2009, China's number of franchise systems increased in just one year by 15 percent.[294] By 2016, China's top 100 franchises alone generated total annual sales equating to $66 billion.[295] China now has over 4,500 franchise networks,[296] even more than the grandfather of franchising, the United States.[297]

290. *See* PRICEWATERHOUSECOOPERS LLP, THE ECONOMIC IMPACT OF FRANCHISED BUSINESSES: VOLUME IV, I-14-15 (Sept. 15, 2016), https://www.franchise.org/sites/default/files/Economic%20Impact%20of%20Franchised%20Businesses_Vol%20IV_20160915.pdf [https://perma.cc/23Z8-KFZN] (concluding that franchised businesses directly or indirectly generated 16,077,500 jobs (nearly nine million of those employees being directly employed by franchised businesses), accounting for 10.1 percent of all U.S. private non-farm employment, and produced $2.1 trillion of annual output (6.8 percent of all private non-farm output) and $1.2 trillion in Gross Domestic Product (7.4 percent of all private non-farm GDP)).

291. These employers met a $351 billion payroll, produced $868 billion of output and added over $541 billion of gross domestic product. *Id.* at I-14.

292. Franchises constituted 53.1 percent of U.S. quick service restaurants ("QSR") and 21.1 percent of hotels, motels, or other lodges, with even higher percentages of franchise-related employments for those sectors; franchises accounted for 68.5 percent of QSR employees, 29.1 percent of lodging employees, 18.0 percent of table/full service restaurant employees and 8.0% of retail food employees. *Id.* at I-9. Elsewhere in the world, while generally similar to the U.S. industry proportions, in part because of American franchisors expansion internationally, various sectors may be more or less likely to have a large proportion of franchised businesses than in the United States. This, though, has little, if any, effect on the franchise law issues.

293. U.S. INT'L TRADE ADMIN., 2016 TOP MARKETS REPORT: FRANCHISING, 5, http://www.trade.gov/topmarkets/pdf/Franchising_Top_Markets_Report.pdf [https://perma.cc/23WK-USFP].

294. Thomas Leclercq & Guillaume Smitsmans, *Franchising in China: Overview and Opportunities*, THIRD PLACE (Dec. 17, 2012), http://www.third-place.be/wp-content/uploads/2012/12/Franchising-in-China-Whitepaper-by-Third-Place-Franchise-Consulting.pdf [https://perma.cc/CSS7-HY92].

295. U.S. INT'L TRADE ADMIN., *supra* note 293, at 19.

296. *Id.*

297. *See FAQs*, SUMMIT FRANCHISES, http://www.summitfranchises.com/faqs.php

Legislative, regulatory, and case law expansion has come on the heels of the surge in franchising. While the criteria for what constitutes a franchise are not uniform, the franchise relationship is defined similarly in all nations. Typically, a franchisor will license a franchise's know-how or trademark to the franchisee, while exercising substantial control over the franchise's marketing plan, in exchange for a start-up fee from the franchisee.[298] With unanimity on the broad outline of the franchise's legal architecture (the contract) and operations (how the franchise relationship is built and maintained), courts, legislators, and regulators should look to require, or at least strongly encourage, franchising's indisputably positive "best practices." Among them are the use of pilot units before franchising begins and the structuring of goodwill compensation mechanisms to encourage network-friendly, productive franchisee and franchisor behavior during the course of the franchise relationship.

A. *Testing the Business Formula*

Most nations do not require that a prospective franchisor test its franchise business model before selling franchises. However, a minority of countries require this business formula testing.[299] Chinese law explicitly requires such testing,[300] and other countries, while lacking such an explicit legal requirement, have, for example, code of ethics norms,[301] case law,[302] or

[https://perma.cc/HA65-4THT] (last visited Nov. 17, 2017) (finding, conservatively, more than 3,000 different U.S. franchise networks in over 70 different industry categories).

298. Emerson, *supra* note 91, at 594-98 (discussing the definition of a franchise relationship).

299. Consider Italy as an example. Its franchise law, enacted on May 6, 2004, states that, for a business to establish a franchising network, it must have tested on the market its "commercial formula." L. n. 129/2004 (It.) (Article 3(2)).

300. *See supra* notes 74-76 and accompanying text (containing the regulations of commercial franchising operations per Chinese law).

301. Article 2.2 of the European Code of Ethics for Franchising provides, "[t]he Franchisor shall . . . have operated a business concept with success, for a reasonable time and in at least one pilot unit before starting its franchise network[.]" EUR. FRANCHISE FED'N, EUR. CODE OF ETHICS FOR FRANCHISING, art. 2.2, at 2-3 (Dec. 5, 2003), http://www.franchise-fff.com/base-documentaire/finish/206/327.html [https://perma.cc/EP8D-GGCA] (reported at the website for the French Franchise Federation - Fédération Française de la Franchise) (hereinafter, "EUR. CODE OF ETHICS FOR FRANCHISING"). In a supporting note, the code states, "[i]t is the duty of the franchisor to invest the necessary means, financial and human, to promote his brand and to engage in the necessary research and innovation to ensure the long-term development and continuity of his concept." *Id.* at 6 (note 5) (French Franchise Federation ("FFF") extensions and interpretations of June 14, 2011).

302. *See supra* notes 100-101 and accompanying text (discussing French case law on commercial franchising operations); Emerson, *supra* note 91, at 620 (discussing know-how and pilot establishments under French franchise law).

franchise organization membership prerequisites[303] that do require or imply the testing of business formulas. At the very least, even without a legal mandate, having a test run of franchise-like, independently-managed pilot units is a "best practice" for prospective franchisors preparing to market franchises. Discussing the need to have a "proven format," a noted British entrepreneur and business commentator wrote:

> Even if you have run company-owned branches for years, you must be aware that things will change when you franchise and you must be prepared to run pilot units at arm's length. . . . Pilot units should, of course, mirror the proposed franchised outlet as far as possible in terms of size, location, catchment area, population profile, staffing and so on. . . . Ideally, you should pilot the concept in two or three places for at least one complete trading cycle. . . . Pilot units also give you the opportunity to write the manual from practical experience rather than theory.[304]

Running pilot units is thus a fundamental aspect of building and maintaining the franchise network's know-how.[305] It is the franchisor's responsibility to maintain and develop know-how, which it in turn transfers to the franchisee[306] for the good of the entire franchise system, not merely individual franchisees.[307] In essence, not to run pilot units, or to perform some equivalent action before selling franchises, is unethical. For a prospective franchisor that is thinking long-term, it is also highly foolish. Indeed, the record of franchising laws and practices to this point seems to indicate there would be little, if any, opposition to making pilot unit operations a default step franchisors ordinarily must take before selling to franchisees.

B. *Protecting the Goodwill*

1. Network Goodwill versus Local Goodwill

Nearly all franchise contracts contain clauses demarcating the

303. *See supra* note 275-277 and accompanying text (discussing the British Franchise Association standards).

304. Brian Duckett, *Turning your business into a franchise*, FRANCHISE WORLD, http://www.franchiseworld.co.uk/archives/661 [https://perma.cc/7QCR-M6C9] (last visited March 2, 2017).

305. *See* EUR. CODE OF ETHICS FOR FRANCHISING, *supra* note 301, at 5 (explaining the flow of information from the franchisor to the franchisee and back again that is guaranteed in the franchisor's right to "know-how").

306. *Id.*

307. *See* Emerson, *supra* note 91 (arguing that the basic concept of *savoir faire* found in many nations' franchise jurisprudence should be applied, either overtly or at least in its effects, in U.S. franchise cases and legislation).

franchisor's ownership of the trademark and concomitant restrictions on a franchisee's use of the trademark.[308] Studies and individual experience indicate that the vast majority of franchise agreements likely contain clauses in which the franchisor states that it has developed the goodwill for the benefit of the franchise system and thereby designates control over the franchisee's behavior as necessary to protect the goodwill.[309] For example, Pizza Hut's franchise agreements state that "[franchisor Pizza Hut International – 'PHI'] is the sole and exclusive owner of the Pizza Hut Marks. . . All goodwill now or in the future associated with and/or identified by one or more of the Pizza Hut Marks belongs directly and exclusively to PHI."[310] Like Pizza Hut International, most franchisors establish their ownership stake in the goodwill by providing that all emanations from the original franchise goodwill belong to the franchisor, even if the franchisee developed the new idea in question.[311] For example, "The Big Mac®, Filet-O-Fish® and Bacon & Egg McMuffin®" were generated by McDonald's franchisees around the world.[312]

The law of franchise goodwill should note the differences between the franchisee's handiwork and that solely ascribed to the franchisor's trademark. Just as American franchise law sometimes distinguishes between types of goodwill,[313] French law separates the ideas of "national goodwill"

308. *See* Emerson, *supra* note 17, at 693 (featuring the results of a survey of 100 U.S. franchise agreements in 2013 which found that 96% had restrictions on the franchisee's use of the franchise system's trademark and that 81% required a terminated franchisee to return to the franchisor all trademarked supplies, signs, stationery, forms or other materials – both figures were nearly the same in a survey of 100 U.S. franchise agreements twenty years earlier – 95% and 78%, respectively).

309. *Id.* at 697 (featuring the results of a survey of 100 U.S. franchise agreements in 2013 which found that 95% had a provision on goodwill).

310. PIZZA HUT, INC. LOCATION FRANCHISE AGREEMENT, at p. 5, para. 3.3 ("OWNERSHIP OF PIZZA HUT MARKS") (filed with California's Department of Corporations on Oct. 18, 2005) (on file with author).

311. Emerson, *supra* note 17, at 694 (featuring the results of a survey of 100 U.S. franchise agreements in 2013 which found that 55% declared that all franchisee concepts become the franchisor's exclusive property, a figure remarkably higher than the 3% bearing such a declaration in 100 such agreements from 1993).

312. *Franchisees Opportunities*, MCDONALD'S NEW ZEALAND, https://mcdonaldsco.nz/franchise-opportunities [https://perma.cc/MX5V-4EZ7] (last visited Jan. 24, 2017).

313. In some states, the franchise relationship laws "may reflect the perception that a franchisee also develops a local and personal goodwill in the business, often called 'sweat equity,' . . . [that] is separate and distinct from the goodwill inherent in the licensed trademarks." Bundy & Einhorn, *supra* note 31, at 183, 216; *see supra* notes 8–12 & 30-32 and accompanying text (concerning locational, reputational, and brand goodwill). Both courts and statutes support the separation of goodwill into different categories. *See* HAW. REV. STAT. ANN. § 482E-6(3) (LexisNexis 2010) (stating that the franchisor must compensate the franchisee for the loss of goodwill if the franchisor refuses to renew a franchise for the purpose of converting the franchisee's business to one owned and operated by the franchisor);

belonging to the franchisor and "local goodwill" belonging to the franchisee.[314] The franchisee generates local goodwill by investing his or her time, effort and capital.[315] Local goodwill contributions strengthen the reputation of the national product or service.[316] Courts and lawmakers acknowledge, "local goodwill necessarily becomes established in the minds of the public toward a particular business at a particular location."[317] For example, a customer may go to a specific franchisee location because of the friendly, efficient employees of that franchisee or the specific site of the business. Positive experiences with one franchisee may encourage a patron to visit the same franchise at other locations and thus become a supporter of the franchise network, not just the franchisee initially patronized. On such occasions, it is the franchisee's assets that are used to attract the customer to the franchisor and then retain his staunch support. Here are three examples of franchisee work leading to local customers who may, nonetheless, identify as franchise-faithful, not forever franchisor or franchisee steadfast: (1) the franchisee often has selected the location where the franchise does business; (2) the franchisee typically maintains the stock and equipment and certainly sells the actual goods or services that the customer seeks; and (3) the franchisee is responsible for hiring, training, and supervising the franchised unit's employees, who in turn often "make or break" the customer experience, and create or destroy any corresponding loyalty to the franchise brand.[318]

Recognition of franchisee goodwill helps to stymy potential abuse of the franchise relationship and to produce a more balanced, fairer network of both centralized power (the franchisor, the brand, the network as a whole) and of local owner-operators (franchisees). Otherwise, "[b]y exercising [or

LaGuardia Assocs. v. Holiday Hosp., 92 F. Supp. 2d 119, 125 (E.D.N.Y. 2000) ("[T]he franchisor is essentially lending its national goodwill to the franchisee [and t]he franchisee . . . generates local [customer] goodwill.").

314. Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., Mar. 27, 2002, Bull. civ. III, No. 00-20732 (Fr.) (known as the Trevisan judgment); *see also* Cour d'appel [CA] [regional court of appeal] Chambery, com., Oct. 2, 2007, No. 06-1561 (Fr.) (another unusually well-known case, called SA Andey c/ SAS Vanica.

315. LaGuardia Assocs. v. Holiday Hosp. Franchising, Inc., 92 F. Supp. 2d 119, 125 (E.D.N.Y. 2000).

316. *Id.*

317. Benjamin A. Levin & Richard S. Morrison, *Who Owns Goodwill at the Franchised Location?*, 18 FRANCHISE L.J. 85 (1999); *see, e.g.*, Shakey's, Inc. v. Martin, 430 P.2d 504, 509 (Idaho 1967) (explaining goodwill initially associated with the mark "becomes established in the minds of the public who patronize the establishment"); Hill v. Mobile Auto Trim, Inc., 725 S.W.2d 168, 171 (Tex. 1987) ("[T]here exists not only business goodwill but also franchisee goodwill.").

318. Cour de cassation [Cass.] [supreme court for judicial matters] 3e civ., Mar. 27, 2002, Bull. civ. III, No. 00-20732 (Fr.).

threatening to exercise] its termination power, the franchisor can unfairly capitalize on local goodwill built up by the franchisee through its investment of capital and labor."[319] If the franchisee has built up favorable local goodwill, customers will continue to frequent the franchise establishment, even once the ex-franchisee has stopped managing it. To avoid this injustice, franchising's statutory, regulatory, and case law framework should take a more active approach to protecting franchisees.

2. Franchise Contract Clauses, Termination, and Goodwill

Franchise contract clauses evidence the unequal bargaining power that exists when franchisees enter into franchise agreements.[320] A California court characterized the issue as follows:

> The relationship between franchisor and franchisee is characterized by a prevailing, although not universal, inequality of economic resources between the contracting parties. Franchisees typically, but not always, are small businessmen or businesswomen. . . seeking to make the transition from being wage earners and for whom the franchise is their very first business. Franchisors typically. . . are large corporations. The agreements themselves tend to reflect this gross bargaining disparity. Usually they are form contracts the franchisor prepared and offered to franchisees on a take-it-or-leave-it basis.[321]

Furthermore, courts have acknowledged that franchise agreements strongly resemble consumer contracts, although in fact they are commercial contracts.[322] Modern courts acknowledge that most individuals do not read

319. Boyd Allan Byers, *Making a Case for Federal Regulation of Franchise Terminations—A Return-of-Equity Approach*, 19 IOWA J. CORP. L. 607, 621 (1994).

> The franchising structure lends itself to franchisor opportunism . . . The franchisee's sunk investment also permits the franchisor to engage in opportunism short of actually exercising its termination power, as the threat of termination itself enables the franchisor to appropriate a portion of the franchisee's sunk investment for itself.

Id.

320. Emerson, *supra* note 17, at 657-59 (reviewing the numerous, strongly pro-franchisor terms of most franchise agreements, which can permit franchisors to exercise a large measure of opportunism throughout the life of the franchise relationship).

321. Postal Instant Press, Inc. v. Sealy, 43 Cal. App. 4th 1704, 1715-16 (Cal. Ct. App. 1996) (citing Robert W. Emerson, *Franchising and the Collective Rights of Franchisees*, 43 VAND. L. REV. 1503, 1509 & n.21 (1990)).

322. Nagrampa v. MailCoups, Inc., 469 F.3d 1257, 1282 (9th Cir. 2006). This is only in some courts, of course, and treating franchisees as consumers is notable for being just a minority of the cases. Also, worldwide, legislatures have tended to avoid this approach, with one prominent exception: South Africa. *See* Emerson, *supra* note 76, at 462-63 (noting that the history and effects of apartheid in South Africa helped lead to passage of that country's

consumer contracts, and especially do not negotiate over their terms.[323] To add to this disparity, most franchisees do not employ the assistance of attorneys when signing these documents and "contracting" for their rights.[324]

Many courts recognize that most franchise agreements are drafted to protect the franchisor's interests. This often results in courts defining the purpose of franchise laws as the protection of franchisee rights from the franchisor's contractual prowess. For example, Canadian courts impose serious consequences on franchisors that do not comply with disclosure requirements.[325] More generally, countries have increasingly invoked agency law principles to even, as they see it, the franchise playing field. German law offers insight on how such pro-franchisee court holdings may ensue once legal authorities accept that a crucial role of franchisors is to provide support for the franchisee in running a business and earning revenues.[326] Courts in turn favor the franchisee by holding the franchisor liable for any damage to the franchisee's financial existence that results from the franchisor permitting other franchisees to compete in the same

2008 Consumer Protection Act, which explicitly classifies franchisees as consumers and bestows upon franchisees a bundle of rights exceeding that of other national franchise laws).

323. Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1174, 1179 & n.22 (1983) (reporting that over the previous few years, he had asked many lawyers and law professors "whether they ever read various form documents, such as their bank-card agreements; the great majority of even this highly sophisticated sample do not").

324. Robert W. Emerson, *Fortune Favors the Franchisor: Survey and Analysis of the Franchisee's Decision Whether to Hire Counsel*, 51 SAN DIEGO L. REV. 709 (2014). *See* Robert W. Emerson & Uri Benoliel, *Are Franchisees Well-Informed? Revisiting Debate over Franchise Relationship Laws*, 76 ALB. L. REV. 193, 215-216 (2013).

> Franchisees ignore disclosure documents, do not compare various franchise opportunities, and refrain from consulting with a specialized franchise attorney. Given this reality, theoreticians and legislators interested in creating franchise laws that protect novice franchisees from possible opportunism by franchisors must cast doubt on the assumption that franchisees are sophisticated, well-informed business people and incorporate into their analyses a more representative conception of franchisee behavior. The assumption that franchisees consider all relevant information before signing a franchise contract has little theoretical or empirical support in actual practice, and thus the door is open to reconsidering the adoption of franchise relationship laws.

Id.

325. Brad Hanna, Les Chaiet & Jeffrey Levine, *Canada*, in INTERNATIONAL FRANCHISING CAN/14 (Dennis Campbell ed., 2d ed. 2011).

326. *See* Hero, *supra* note 216, at 9 (noting the franchisor has a "business promotion obligation . . . geared towards supporting the franchisee" in advancing the franchisee's "aim of running a system business and earning revenues"; to do that, the franchisor must, *inter alia*, protect franchisees from the existential threat of other franchisees' competition, furnish to franchisees advice and information, and otherwise refrain from "actively frustrating" franchisee goals).

territory.[327]

This trend of favoring the franchisee should, as a matter of fairness and efficiency, continue into the context of goodwill compensation upon termination of the franchise relationship.

Although most countries do not recognize goodwill compensation to the franchisee, there are a few exceptions. In the United States, compensation is only recognized in cases in which the franchisor has violated the parties' franchise agreement.[328] However, goodwill has come to be known as a distinct "asset" separable from the franchise or trademark it is associated with – perhaps evincing a mindset that goodwill is an item for which parties should be compensated.[329] Additional exceptions are France, which recently recognized franchisees' claims to goodwill compensation,[330] and Australia, which distinguishes between business goodwill belonging to the franchisor and local goodwill belonging to the franchisee.[331] Other countries, such as China, do not explicitly address goodwill under franchise laws, but instead do so under agency principles.[332] These countries apply similar standards when determining whether the agent (franchisee) can recover for goodwill: mainly, (1) that the franchisee increased the franchisors clientele; (2) that the franchisor benefitted from this substantially; (3) that the franchisee has lost commissions or payments from this increased clientele; and (4) that, under the circumstances, it is fair and equitable to award goodwill compensation to the franchisee. This is a standard suitable for American franchise law adjudication, arbitration, regulation, and

327. *Id.*

328. *See supra* Part I.A.2. (discussing the difference of goodwill treatment by American state courts, explaining that while some do not require the franchisor to repurchase goodwill upon termination of the agreement unless the franchisor was the party at fault, others hold that franchisors must always pay for the local goodwill the franchisee created during the contract).

329. Irene Calboli, *Trademark Assignment "With Goodwill"; A Concept Whose Time Has Gone*, 57 FLA L. REV. 771 (2005).

330. *See supra* Part I.C.2. (explaining that historically under French law the goodwill in a franchise remained with the franchisor, but around 2000 France began recognizing the franchisee's right to goodwill with several new cases, the most influential being *Sarl Nicogli Le Gan Vie SA*).

331. *See supra* Part I.F.2. (explaining that because Australian law views goodwill as a derivative product of a recognized trademark, specific location or the reputation of the business, it is an asset in its own right, and one that requires the courts to distinguish the sources of the goodwill to then properly assign its ownership to either the franchisor (declaring it predominantly business goodwill) or the franchisee (declaring it predominantly local goodwill)).

332. *See supra* Part I.B.2. (explaining that because Chinese law does not provide for compensation beyond damages, it is up the parties to provide said compensation by the terms of the contract between them, and since China's agency laws, the only Chinese of body of law which govern franchises, also defers greatly to the importance of contract terms, any right to goodwill must be included in the contract).

legislation.

3. A Presumption in Favor of Franchisee Compensation

Adoption of a uniform, international standard for the treatment of goodwill in franchising could be a boon for franchisors, franchisees, and world commerce generally. Even without legislation or regulation, improvement is possible: As adopted in dispute resolution or jurisprudence, the modern, more general view that often favors franchisees can contribute to an international consensus about the treatment of franchisee goodwill. Therefore, while it is unrealistic to expect universal franchise *laws* when countries value consumerism and freedom of contracting at different rates, a customary approach to goodwill may prevail in light of current trends recognizing the disparities in the franchise relationship. The Model International Franchise Contract ("MIFC"), written by a European-based organization, issued revised rules containing an introductory remark that indicated "courts may in some exceptional cases find a way to grant the franchisee a goodwill indemnity or similar remuneration in case of contract termination. . ."[333] That recognition of heightened franchisee rights, while limited to "some exceptional cases," signifies an ongoing shift in the attitudes of business leaders, jurists, and scholars toward reimbursing franchisees for lost goodwill.

This Article proposes that all courts raise a presumption favoring goodwill compensation in the franchisee's favor when the franchise relationship is terminated. This presumption can be rebutted by the franchise agreement expressly containing a provision related to goodwill treatment upon cessation of the relationship, with special clauses related to termination due to bad faith actions (e.g., trademark infringement) by the franchisee. Where the franchise relationship is largely governed by the parties' franchise agreement, and thus typically favors the franchisor (evinces the franchisor's "upper hand"), a presumption in favor of the franchisee would help level the playing field. Considering the one-sided nature of franchise form contracts,[334] this presumption would be especially important for businesses

333. International Chamber of Commerce, Model International Franchising Contract 15 (2011) (discussing rules protecting the franchisee).

334. *See* Emerson, *supra* note 17, at 657-59, 689-93 & 696-701 (reviewing examples of the numerous, strongly pro-franchisor terms in most franchise agreements, and providing an appendix featuring surveys of franchise contracts from 1971, 1993, and 2013 showing over time an even greater pro-franchisor slant in most franchise contract terms, such as fees, indemnification, territories, site selection and layout, operating standards, prices, supplies, inspections, intellectual property, advertising, leases, non-compete covenants, and franchise transfers and assignments); Emerson, *supra* note 8, at 366-367 (citing numerous commentators and empirical studies for the proposition that franchise agreements tend to be

operating internationally; these businesses now could expect consistent treatment across borders, and – in reliance on the new standards – these businesses could maintain stable, finely calibrated, even standardized business operations regardless of the location. Furthermore, a universal presumption of awarding goodwill to franchisees upon termination of the franchise relationship would encourage franchisors to contractually protect goodwill rights, rather than depend upon courts to allocate compensation.

Certainly, the bargaining power of franchisors could outweigh the courts' presumption in favor of franchisee goodwill. However, pro-franchisor contract provisions may not simply doom a presumption. First, concepts of good faith and fair dealing would still apply,[335] and franchisee advocates could challenge a franchisor's crafting and enforcement of such clauses, whether in litigation or arbitration, in regulatory or legislative processes, or in the court of public opinion. Compelling franchisors to allocate more fairly the goodwill generated by all the franchisor network

strongly tilted in favor of franchisors, that they are long and usually opaque, and – as with most such form contracts – are not carefully read, let alone negotiated, by the party (the franchisee) subjected to these agreements' often onerous terms).

335. *See* W. Michael Garner, 2 Franchise and Distribution Law and Practice § 8:1 (2017) (stating that under U.S. law, "[m]odern franchise and distribution relationships are usually based upon agreements that include the written agreements between the parties, their oral agreements, the custom of the trade and course of dealing between the parties, statutory law, and *the implied covenant of good faith and fair dealing*" (emphasis added)); Robert W. Emerson, *Franchising and the Parol Evidence Rule*, 50 AM. BUS. L.J. 659, 723 & n.298 (2013) (citing many American cases for the proposition that the franchise relationship creates implied covenants of good faith and fair dealing). The franchise parties' duties of good faith and fair dealing toward one another (franchisor *and* franchisee) are found in franchise law worldwide. It extends to the Civil Law nations, Babette Märzheuser-Wood, *Drafting Franchise Agreements in Civil Law Jurisdictions*, *in* FUNDAMENTALS OF INTERNATIONAL FRANCHISING 317, 321 (Will K. Woods, 2d ed., 2013) (citing numerous Civil Code jurisdictions, noting that a "general obligation of 'good faith' will be implied into the [franchise] contract by most civil codes," and stating that the good faith duty in the Civil Law nations covers both performance of the contract as well as pre-contractual negotiations); Emerson, *supra* note 216, at 188 & n.138 (The Civil Code, found in French law). It also extends beyond the United States to all other common law countries. *See* JENNY BUCHAN, FRANCHISEES AS CONSUMERS: BENCHMARKS, PERSPECTIVES AND CONSEQUENCES 158 (2013) (noting that "fairness" and "good faith" are the standard for evaluating Australian franchise contracts, yet may be inadequate for protecting franchisees of failing franchisors); Mohd Bustaman Hj Abdullah & Wong Sai Fong, *Malaysia*, *in* INTERNATIONAL FRANCHISE SALES LAWS 343, 360 (Andrew P. Loewinger & Michael K. Lindsey eds., 2d ed. 2015) ("Section 29 of the [Malaysia Franchise] Act provides that the Franchisor and Franchisee must act in an honest and lawful manner and must endeavor to pursue the best franchise business practices under the circumstances"); Emerson, *supra* note 76, at 473, 476, 479 & 481 (noting the good faith and fair dealing franchise law concepts found in South African law, as well as, in order, the law of France, Australia, and China); Snell, Weinberg & Mochrie *supra* note 153, at 128-29 (discussing the substantive law requirements for franchise contracts that are found in the provincial legislation in Canada and that imposes a duty of fair dealing in franchising).

participants (franchisors and franchisees alike) may actually result from these three factors counteracting the franchisor's freedom simply to declare its absolute ownership of all franchise-related goodwill: (1) disclosure obligations about who owns the goodwill, both under the law and – when applicable - under a contract provision; (2) transparency via social media and other Internet-based information; and (3) competition among franchisors seeking to attract and retain franchisees. Such protection will promote maintenance of business relationships as well as encourage terminated franchisees to continue their business ventures.

Courts should raise a presumption in the franchisee's favor while allocating goodwill compensation upon the franchise relationship's termination. This approach permits the parties to make market choices, to draft contract terms according to their needs, yet subject to standards meting societal notions of fairness and equity. As customers acquire loyalties to a brand but also, more particularly, a franchised business, the reward for those clientele memories should be rights, or at least presumptions, favoring that business when the franchisor severs the business' connection to the brand. The franchisee should receive from the terminating franchisor more than mere thanks for those memories – those valuable ties to customer loyalty - that the franchisee has helped to create. Legal presumptions should favor franchisee compensation from the franchisor for the goodwill accruing to the franchisor, or now lost to the franchisee, or both, when the franchise is terminated.