Master Franchising:
Is It Right For You?
How Can You Minimize Time And Legal Expenses?

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Carl Zwisler, an international franchising lawyer, works from the Washington, DC office of Gray Plant Mooty.

❖ Advises franchisors and master franchisees throughout the world in structuring, drafting and negotiating international agreements.
❖ Authored book on international master franchising.
❖ Developed and moderated symposia on international master franchising at International Franchise Expo for 15 years.
❖ Recognized by U.S. Commerce Department and State Department as a leading authority on the legal and business aspects of structuring and negotiating international franchise agreements.
❖ Regularly updates IFA International Committee on international regulatory developments affecting franchising.
❖ Prepared and delivered more than 200 presentations and articles on all aspects of international franchising.
❖ Authored more than 20 presentations and articles on exporting a franchise to the U.S.
❖ Served as IFA General Counsel, Chair of the IFA Supplier Forum, Chair of IFA’s SBA Franchise Registry Task Force, and as U.S. Franchise Law Expert for the International Distribution Institute.
Franchising Formats Used In International Franchising

- Unit
- Area Development
- Master
Franchising Formats

**Unit Franchising**

Franchisor grants ↓

Unit franchisee ↓
Right to conduct business using franchisor’s trademark and operating systems ↓
Payment of Fee
Franchising Formats

Area Development Franchising
(multi-unit franchising)

Franchisor grants ↓
Area Developer territory

<table>
<thead>
<tr>
<th>Franchise Unit 1</th>
<th>Franchise Unit 2</th>
<th>Franchise Unit 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>By January 1, 2018</td>
<td>By July 1, 2018</td>
<td>By January 1, 2019</td>
</tr>
</tbody>
</table>
Area Development Agreement
Provides:

• Develop three units during next 12 months
• Sign a unit franchise agreement for each
• Pay area development fee
• Pay unit franchise fee when each franchise agreement is signed
Master Franchising
Franchisor grants ↓
Master Franchisee (subfranchisor)
Right to sell unit franchises (subfranchises) within a defined territory ↓
usually at a rate set by a development schedule during a defined period of time
Master Franchising

Master Franchisee pays
  ↓
  Franchisor
  ↓
  a master franchise fee and a portion of initial and ongoing fees derived from each Unit Franchisee
# Comparison of International Franchising Strategies

<table>
<thead>
<tr>
<th></th>
<th>Relative Cost</th>
<th>Relative Speed</th>
<th>Relative Return</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Unit</strong></td>
<td>Cheapest</td>
<td>Slowest</td>
<td>Lowest</td>
</tr>
<tr>
<td><strong>Area Development</strong></td>
<td>Mid</td>
<td>Mid-high*</td>
<td>Mid-high*</td>
</tr>
<tr>
<td><strong>Master</strong>**</td>
<td>Highest</td>
<td>Highest*</td>
<td>Highest*</td>
</tr>
</tbody>
</table>

* Depends on number of units developed and franchisor’s share of fees

** Objective of master franchising is fastest growth with fewer resources than Area Development requires
Time Needed To Break Even

Shortest

Area Development *

Master*

Unit

Longest

* Assumes same rate of growth
How Franchising Format Selected Affects Legal, Training And Translation Expenses

<table>
<thead>
<tr>
<th></th>
<th>Number of:</th>
<th></th>
<th></th>
<th></th>
<th>Filings*</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Agreements</td>
<td>FDDs</td>
<td>Manuals</td>
<td>Training Programs</td>
<td></td>
</tr>
<tr>
<td>Unit</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Area Development</td>
<td>2</td>
<td>1</td>
<td>2</td>
<td>Unit &amp; AD</td>
<td>1</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>1 or 2</td>
<td></td>
</tr>
<tr>
<td>Master</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>Unit &amp; Franchisor</td>
<td>2</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2</td>
<td></td>
</tr>
</tbody>
</table>

* in country where franchise or license agreements must be filed
## Franchisor Share Of Revenue Using Different Franchising Strategies

<table>
<thead>
<tr>
<th></th>
<th>Initial Fee (Primary Franchisee)</th>
<th>Initial Fee (Operating Unit)</th>
<th>Royalty</th>
<th>Other Fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unit</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Area Development</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
<tr>
<td>Master</td>
<td>100%</td>
<td>Shared*</td>
<td>Shared*</td>
<td>Shared*</td>
</tr>
</tbody>
</table>

* The portion shared sometimes differs for a Master Franchisee’s company-owned outlets
How To Avoid Key Problems In International Master Franchising

1. Define expectations for
   - Franchisor
   - Territory
   - Master Franchisee

2. Develop expansion plans that define what is needed for the franchisor to meet its expectations and a master’s reasonable expectation
3. Confirm that Master Franchisee candidates understand Franchisor’s expectations and have the experience, resources, passion and leadership needed to succeed

4. Require Master Franchisee candidates to prepare business plans defining the resources that will be required, when they will be required, and demonstrating their availability
5. Confirm that the Master Franchisee candidate understands likely potential problems arising from execution of the plan and understands consequences if requirements are not met.
Legal Requirements

1. Master Franchise Agreement
2. Subfranchise Agreement
3. Area Development Agreement
   a. In countries with franchise disclosure laws, Master Franchise Disclosure Document
   b. Subfranchise Disclosure Document
   c. Audited financial statements
      i. Franchisor
      ii. Master
4. Registrations e.g., U.S., Spain, Russia, Brazil, China, South Korea
5. Trademark registrations or applications
Time & Costs of Master Franchising

1. Preparation of international franchising plan
2. Development of standard international franchise agreements
3. Localization of standard franchise agreements
4. Preparation of international franchise disclosure documents (FDD)
5. Preparation of country- (or state-) specific FDDs
6. Translating all agreements, FDDs, manuals, advertisements, menus to comply with local requirements or best practices

7. Obtaining franchise registrations

8. Obtaining other permits required for master to remit funds from the country

9. Retaining staff or consultants familiar with international franchising to assist in development of international marketing plan
10. Recruiting and vetting master franchise candidates
11. Reviewing candidates’ business plans
12. Negotiating master franchise and subfranchise agreements
13. Completing any requirements to collect fees from Master and for Master to comply with withholding tax and currency repatriation and currency conversion requirements
14. Completing any requirements to collect fees from Master and for Master to comply with withholding tax and currency repatriation and currency conversion requirements

15. Establishing supply chain in master franchise territory (MFT)
16. Establishing and delivering training program for Masters

a. Recruiting, training and supporting Subfranchisees in the MFT

i. Developing Master Franchise Training Manuals and Programs for operations

ii. Developing Master Franchise Training Programs for recruiting/training/supporting Subfranchisees in the MFT
17. Working with Master to adapt franchise to local market’s legal, business, and cultural norms
18. Providing onsite support to Master when opening pilot units and when recruiting and training initial subfranchisees
How to Minimize the Time and Expense of Achieving International Master Franchising Profitability—Legal Issues

1. Plan: research markets; establish priorities, budgets and realistic cash flow projections
2. Obtain full support from CEO and Board
3. Register trademarks and domain names in targeted countries before beginning recruiting
4. Develop standard international agreements and LOI forms

5. Work with experienced international franchise development professionals, international franchise counsel and experienced local franchise counsel

6. Develop international FDDs that include standard terms and information about the franchise to reduce negotiation time and expense and comply with good faith requirements
7. Develop integrated documents, using identical terminology and include standard definitions in one agreement which is cross-referenced in related agreements to reduce translation costs.

8. Obtain good faith deposits with LOIs where permitted by law.

9. Perform due diligence on candidates no later than when LOI is executed.
Thank You

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