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INTERNATIONAL JOINT VENTURES IN FRANCHISING

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1 Introduction[*]

As international consumer culture has become increasingly vigorous through globalization and "glocalization" fueled by the internet and communications media, consumer demand has risen sharply for goods and services from globally known and trusted brand operators. The resulting opportunities for brand expansion into new markets carry irresistible allure for franchisors, who with careful planning, structure, and execution can successfully translate domestic popularity into international preeminence.

A multitude of factors differentiates each potential new international market. Franchisors, with the aid of legal practitioners and business consultants, must conduct an individualized analysis for every potential new market in order to choose the optimal franchise relationship structure to maximize benefits, take advantage of efficiencies, and minimize drawbacks. A number of common structures are used in international systems, namely company-owned operations, direct unit franchising (including direct single unit and multi-unit/area development agreements), master franchise agreements, and joint ventures. Each has advantages and disadvantages in light of the particular characteristics of the target market.

Although no one approach is one-size-fits-all, this paper specifically focuses on the joint venture approach applied to international expansion. Among other things, this paper addresses the specific considerations that may motivate a franchisor to opt for a joint venture over other expansion methodologies, different ownership structures among the venture's participants, and how joint venture arrangements can be structured to facilitate compliance with and mitigate the effects of underlying laws and regulations governing franchise systems.

2 Factors for Consideration in Structuring International Franchise Expansion

2.1 Legal and Regulatory Climate. Some countries have complex laws governing franchise relationships, while in others, franchise-related laws are less burdensome. In yet other countries, franchise laws have not yet been adopted. In most western countries, franchise laws are seen as limiting franchisors' range of options, while in some markets, franchise laws are seen as legitimizing and authorizing franchising. Even absent franchise-specific laws and regulations, rules governing competition,[1] contracts, agency, intellectual property, etc. can have enormous impact on an effective franchising strategy.[2] Elements of institutional uncertainty[3] in the region, such as corruption, the nonexistence or irregular enforcement of laws governing intellectual property and franchising, and political forces adverse to foreign business influences may also play

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[1] Strict antitrust regulations, for example, can undermine a franchisor's ability to grant protected territory in Area Development and Master Franchise agreements. *See* Nick Pimlott & Martin Mendelsohn, *Reform of European Union Rules on Distribution*, FRANCHISING WORLD (Jan. 2010).

[2] *See*, *e.g.*, Xiao Xiaowen & Hu Yong, *China's Intellectual Property Protection in Franchising*, 9 FRONTIERS OF LAW IN CHINA, no. 4, 2014, at 672 (discussing the importance of carefully vetting partners and franchisees in light of China's unique approach to intellectual property protection).

[3] Maria Jell-Ojobor & Josef Windsperger, *Determinants of the Governance Structure of the International Franchise Firm*, 34 INT'L MKTG. REV. 814, 851 (2017).

a key role in influencing business decisions about expansion.[4] The domestic laws[5] and diplomatic agreements of the franchisor's home country with the target country (or, conversely, boycotts/embargoes)[6] are additional related factors. Finally (and perhaps most importantly to some franchisors), there may be laws in the country that restrict franchisors' options for dispute resolution.[7]

2.1.1 Franchise Law. In some jurisdictions, traditional franchise systems are subject to franchise-specific legislation that focuses upon pre-sale disclosure. Other franchise laws may govern the ongoing relationship between franchisor and franchisee, regulating franchisor influence on franchise operations and placing restrictions on the parties' ability to make changes to the franchise agreement or terminate the relationship. Examples of franchise laws can be found in several European countries, including Italy, Spain, and Sweden.[8] In The Netherlands, a draft bill is being prepared along the same lines, and Greece is preparing the introduction of disclosure laws.[9] In many jurisdictions, however, including India, Cambodia, Chile, Austria, and even Hong Kong, there is no specific franchise law: the business relationship is essentially governed by the commercial understanding reached by the franchisor and the franchisee.

2.1.2 Commercial & Agency Law. Generally commercial and agency law will apply regardless of whether franchise-specific laws and regulations exist, and franchisors must be aware of jurisdictional differences between markets when forming business contracts. Regional perspectives on fundamental elements of the franchise relationship (such as the concept of "fair dealing") can be crucial. [10] To that point, contract provisions that come standard for

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4 *See generally* Jay van Wyk, *Political Sources of International Business Risk: An Interdisciplinary Framework*, 9 J. OF INT'L BUS. RES., no. 1, 2010.

5 For example, the U.S. Foreign Corrupt Practices Act, 15 U.S.C. §§ 78dd-1, et seq., has broad scope and applicability to franchised businesses with U.S. ties, holding them to anti-corruption standards that may exceed the scope of anti-corruption laws and norms in the target market.

6 *See* van Wyk, *supra* note 4, at 115.

7 *See, e.g.*, Han Seungsoo, *Protection of the Franchisee of the International Franchise Contract and the Governing Law in the Litigation* [abstract], 58 SEOUL L.J., no. 3, at 77 (2017) (discussing ways in which Korean law can override choice-of law and choice-of-venue provisions in franchise agreements).

8 Italian Law No. 129/2004; Swedish Franchise Disclosure Act; Spanish Retail Commerce Law and Spanish Royal Decree 201/2010 on Franchise Agreements and the Franchisor's Register.

9 In the Netherlands, a draft bill on franchise was sent to the Dutch Council of State for advice in July 2019 and will likely be sent to Parliament in 2019. Available (in Dutch) at https://www.rijksoverheid.nl/actueel/nieuws/2019/07/12/nieuwe-wet-franchise-naar-de-raad-van-state. In Greece a draft law is under preparation to govern disclosure requirements. *See* Yanos Gramatidis, *Greece: Overview*, THOMSON REUTERS PRACTICAL LAW: FRANCHISING GLOBAL GUIDE (Feb. 1, 2019).

10 Civil and common law jurisdictions have drastically different perceptions of fairness, and a contract of adhesion that would be perfectly acceptable in the United States or Great Britain may be unusable in South Korea. Paul Steinberg & Gerald Lescatre, *Beguiling Heresy: Regulating the Franchise Relationship*, 109 PENN ST. L. REV. 105 (2004). For a more detailed conversation on good faith and fair dealing, see Andrew Terry, Cary Di Lernia & Rozenn Perrigot, *The Obligation of*

franchisors in most markets may be inoperative in others. In India, for example, a non-compete is generally unenforceable except when it involves the sale of goodwill. In India's promoter-driven market, franchisees may have multiple (often competing) business interests, so insulating the franchise business and enforcing non-compete obligations often poses a practical challenge for the franchisor.

Franchise relationships may also be influenced in certain jurisdictions by regional or national laws on commercial agency that include provisions regarding the payment of goodwill compensation. In many countries, there are no mandatory requirements for a franchisor to pay goodwill compensation to the franchisee upon termination, in which case the parties are free to set goodwill compensation terms when the term comes to an end, or to exclude them altogether from the franchise agreement. Examples of jurisdictions where this is currently the case are (among many others) The Netherlands, Italy, South Africa and Singapore.[11] In certain circumstances however, goodwill compensation laws may apply analogously to distribution and/or franchise agreements, which would create an obligation for the franchisor to make a goodwill compensation payment at the end of a franchise agreement.[12] Such 'analogous application' may occur in quite a few countries in the EU,[13] and if the EU Commercial Agency Directive is applied, a range of mandatory requirements will apply in addition to mandatory goodwill compensation.[14] Other specific examples of analogous application can be found in the national laws of Germany[15] and Austria.[16]

2.1.3 Intellectual Property. Protection of the franchisor's intellectual property assets, such as trademarks, service marks, trade name, signs and other business marks, is a major issue that is of central importance in all franchise arrangements. In countries like India,

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Good Faith and Its Role in Franchise Regulation in *The Handbook of Research on Franchising* (Frank Hoy, Rozenn Perrigot & Andrew Terry, eds., 2017).

11 *See* Martine de Koning, *The Netherlands: Overview*, THOMSON REUTERS PRACTICAL LAW: FRANCHISING GLOBAL GUIDE (July 1, 2019); Danie Strachan & Andre Visser, *South Africa: Overview*, THOMSON REUTERS PRACTICAL LAW: FRANCHISING GLOBAL GUIDE (July 1, 2018); Woon Chooi Yew & Elaine Lew, *Singapore: Overview*, THOMSON REUTERS PRACTICAL LAW: FRANCHISING GLOBAL GUIDE (Sept. 1, 2018).

12 A commercial agent is a self-employed intermediary who has continuing authority to negotiate the sale or the purchase of goods on behalf of a principal and is remunerated therefore, or to negotiate and conclude such transactions on behalf of and in the name of that principal.

13 Council Directive 86/653 of Dec. 18, 1986 on the Coordination of the Laws of the Member States Relating to Self-Employed Commercial Agents, 1986 O.J. (L 382/17).

14 Case C-381/98, *Ingmar GB Ltd v. Eaton Leonard Technologies Inc.*, 2000 E.C.R. I-09305.

15 Section 89b German Handelsgesetzbuch applies analogously in the case of termination of a franchise agreement if two conditions are met: (1) the franchisee is included in the franchisor's sales organisation to the extent that it has duties that to a considerable extent are financially comparable to those of a commercial agent; and (2) the franchisee is contractually obliged to (directly or indirectly) transfer its customer base to the franchisor no later than at the termination of the agreement.

16 Austrian Commercial Agent Act.

where there is a high risk of counterfeiting and piracy, robust mechanisms often must be implemented to protect the franchisor's IP. Similarly, in countries with first-to-file policies and strict national registration requirements, such as China and South Korea, franchisors must diligently pursue IP registration and maintenance to mitigate the risk of losing their trademark rights to third parties. In these jurisdictions, a franchisor could be obliged to engage in dispute resolution proceedings to assert its rights,[17] and even to modify its trademark should its efforts be unsuccessful.[18]

2.1.4 Foreign Investment Restrictions. In some countries and industries, foreign franchisors are prohibited outright from directly investing in the market,[19] while others have restrictions based on ownership interest. For example, a foreign franchisor wishing to invest in or license its brand to an Indian franchisee must comply with Indian regulations governing Foreign Direct Investment (**FDI**). As per the FDI policy, foreign investors can invest in India either through the automatic or the government approval route. Under the automatic route, no prior approval is required for foreign investment, whereas in the case of the approval route, government approval must be obtained before making any foreign investment. Notably, foreign investment in single brand retailing is permitted up to 49% under the automatic route and above 49% through the approval route.[20] In the case of multi-brand retailing, the maximum foreign investment is 51%, but that too requires proceeding under the approval route.[21] Japan,[22] Indonesia,[23] and other countries employ similar regulations, directly restricting foreign investment to varying degrees. Foreign

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17 Franchisors have numerous dispute resolution options, among which are litigation in the domestic courts and international arbitration through the World Intellectual Property Organization, but costs of regaining IP rights can be high. For example, Apple was forced to pay USD 60 million in 2012 to Taiwanese Proview Electronics before it could begin to use its iPad trademark in China. Kitsuron Sangsuvan, *Trademark Squatting*, 31 WIS. INT'L L.J. 252, 257 (2013).

18 Pharmaceutical giant Pfizer was forced to adopt a meaningless transliteration of *Viagra* in China after Chinese company Guangzhoi Viamen registered the common name for the drug. *See id.* at n.37 The owner of the French wine brand *Chateau Listran* was similarly obliged to change its name to '*L'Estran*' after it found its original mark had been registered by a third party. Jane Anson, *Bordeaux Chateau Changes Name to Bypass Chinese Trademark Squatters*, DECANTER (Sept. 26, 2013).

19 In China, for example, foreign automotive companies are required to form joint ventures with state-owned enterprises as a condition of market entry. Katherine Koleski & Nargiza Salidjanova, *China's Technonationalism Toolbox: A Primer*, 2, U.S.-CHINA ECON. AND SEC. REV. COMM'N (Mar. 28, 2018).

20 Consolidated Foreign Direct Investment Policy Circular of 2017, ¶ 5.2.15.3 (*Single Brand Product Retail Trading*), Ministry of Commerce & Industries, Dep't of Industries, Policy & Promotion (Aug. 28, 2017), https://dipp.gov.in/sites/default/files/CFPC_2017_FINAL_RELEASED_28.8.17.pdf

21 Consolidated Foreign Direct Investment Policy Circular of 2017, ¶ 5.2.15.4 (*Multi Brand Product Retail Trading*), Ministry of Commerce & Industries, Dep't of Industries, Policy & Promotion (Aug. 28, 2017), https://dipp.gov.in/sites/default/files/CFPC_2017_FINAL_RELEASED_28.8.17.pdf

22 Kenichi Sadaka & Aoi Inoue, *Japan: Franchise 2019*, INTERNATIONAL COMPARATIVE LEGAL GUIDES (Sept. 18, 2018), https://iclg.com/practice-areas/franchise-laws-and-regulations/japan.

23 *See* Indonesian Presidential Regulation 39/2014, restricting retail businesses to 100% domestic capital investment.

investment may also be subject to sector-specific restrictions such as entry conditions, end-use restrictions, lock-in period, etc. Conversely, there are no restrictions in EU countries for a foreign franchisor to invest in national businesses with respect to joint ownership or control, except in public sectors such as healthcare.[24] Even in certain traditionally protectionist economies, such as China, restrictions have been incrementally loosened in recent years to encourage foreign investment.[25]

Foreign exchange controls may also apply concurrently with capital controls, especially in developing or transitional economies.[26] In such emerging markets, like India, which does not have full convertibility of the rupee, there may be share valuation norms applicable on transfer of shares between residents and non-residents, which will override the parties' contractual provisions in case of inconsistency.

2.1.5 Customs and Consumer Protection. The franchisor may need to adapt its product or service to national consumer and safety compliance laws that differ from those of its home market.[27] Franchisors must also take into account the impact of data privacy laws and other consumer protection regulations, which can subject the unwary franchisor to significant obligations and expose non-compliant parties to hefty fines. Navigating around these exacting regulations requires careful planning and attention, but their effect may be mitigated in certain circumstances by careful structuring of the business entities.[28]

2.1.6 Cartel Prohibition & Antitrust. Most franchisors seek to apply non-compete clauses (including both in-term and post-term restrictions), exclusive purchasing, and other restrictions in their franchise agreements. In certain jurisdictions, however, imposing such restrictions in a franchise agreement could place franchisors on the wrong side of the relevant antitrust laws and regulations. In the EU, for example, a franchisor may run the risk of high fines imposed by European or national competition authorities if its contractual restrictions fail to meet the applicable standards.[29] Restrictions that fall outside the scope of the EU regulations (e.g.,

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24 *See* Iain Bowler et al., *Franchise Laws and Regulations 2019*, INTERNATIONAL COMPARATIVE LEGAL GUIDES (Sept. 18, 2018), https://iclg.com/practice-areas/franchise-laws-and-regulations (Reviewing foreign investment restrictions in EU countries Germany, France, Sweden, Turkey, Poland, Italy, Switzerland, and England and Wales).

25 *See* Markus Taube & Mehmet Ögütçü, *Main Issues on Foreign Investment in China's Regional Development: Prospects and Policy Challenges*, 41, in *Foreign Direct Investment in China – Challenges and Prospects for Regional Development*, OECD (2002).

26 Under IMF rules, only countries in a state of economic transition may legitimately restrict currency exchange. Articles of Agreement of the IMF, Art. XIV, § 2 (amended 2016).

27 *See generally* Lionel Fontagné et al., *Product Standards and Margins of Trade: Firm-level Evidence*, 97 J. OF INT'L ECON. 29, 31 (2015).

28 For example, the European Union's General Data Protection Regulation restricts cross-border data transfers to countries with "inadequate" data protection (including the United States). Structuring the franchise in such a way as to keep personal data within the foreign market would facilitate compliance and reduce risk. *See* Gaylen Knack, Michael Cohen & Amanda McAllister, *Ready for GDPR?* FRANCHISING WORLD (Aug. 2018).

29 Article 101 of the Treaty on the Functioning of the European Union (TFEU) prohibits anticompetitive practices that distort the community market. Consolidated Version of the Treaty on the Functioning

agreements in which the franchisee's and franchisor's combined market share does not exceed 30%, or non-compete obligations of less than five-year duration) are exempt from the EU cartel prohibition, but other restrictions commonly found in international franchise agreements might be vulnerable to being deemed anticompetitive.[30] Outside the EU, in for example China and the United Arab Emirates, non-compete and exclusivity clauses are generally not limited by statutory provisions,[31] and in the US, many vertical restrictions are generously evaluated subject to the 'rule of reason,' but Japan and many countries in South America and Eastern Europe follow a stricter approach comparable to that utilized in the EU.

Fortunately, many jurisdictions (including the EU) recognize the special circumstances applicable in franchise relationships. Restrictive provisions during the term of a franchise agreement that are necessary to protect the know-how and goodwill licensed to the franchisee, and those necessary to maintain the public reputation and identity of the franchised brand, are generally deemed to fall outside the realm of anti-competitive restraints.[32] Conversely, post-termination non-compete obligations do not enjoy franchise-specific treatment in the EU and can only be block-exempted if those restrictions do not exceed one year and are limited to the premises of the former franchise unit. Where franchise agreement provisions are not specifically block-exempted, a full assessment in the economic context is necessary to determine whether an individual exemption applies. The EU cartel prohibition laws also prohibit distribution franchisors from restricting franchisees that seek to passively sell outside an exclusively allocated territory. Internet sales restrictions, whether direct or indirect, are also prohibited,[33] except where they concern block-exempted internet platform bans or the selective distribution of certain luxury or technically-complex products.[34] The franchisor may require its franchisees to comply with certain quality and brand standards when reselling its goods.[35]

Franchisors may also prefer in some cases to influence (if not control) retail prices or

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of the European Union art. 101, May 9, 2008, 2008 O.J. (C 115) 47 [hereinafter TFEU]. *See also* Council Regulation 1/2003.

30 Article 101 TFEU applies if there is appreciable effect on the trade between EU member states. In national cases, national laws apply, but these are based on EU law. *See also* Commission Regulation 330/2010 of April 20, 2010, Vertical Block Exemption Regulation, 2010 O.J. (L 102) [hereinafter VBER]; European Commission Guidelines on Vertical Restraints § 190(b), May 19, 2010, 2010 O.J. (C 130) [hereinafter Guidelines on Vertical Restraints]. *See also* Pimlott & Mendelsohn, *supra* note 1.

31 Paul Jones & Xin (Leo) Xu, *China: Franchise 2019*, INTERNATIONAL COMPARATIVE LEGAL GUIDES (Sept. 18, 2018), https://iclg.com/practice-areas/franchise-laws-and-regulations/china; Hamdan Al Shamsi & Omar Kamel, *United Arab Emirates: Franchise 2019*, INTERNATIONAL COMPARATIVE LEGAL GUIDES (Sept. 18, 2018), https://iclg.com/practice-areas/franchise-laws-and-regulations/united-arab-emirates.

32 *See, e.g.,* Case 161/84, *Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis*, 1986 E.C.R. 00353 at ¶ 16; VBER art. 5; Guidelines on Vertical Restraints § 190(b).

33 Case C-439/09, *In re Pierre Fabre Dermo-Cosmétique*, 2011 E.C.R. I-09419.

34 Case C-230/16, *Coty Germany GmbH v. Parfümerie Akzente GmbH*, ECLI:EU:C:2017:941 (2017).

35 Guidelines on Vertical Restraints § 54.

advertising of retail prices, which can also fall afoul of antitrust regulation in some jurisdictions. Vertical price maintenance by a franchisor is prohibited in the EU and subject to fines, [36] and even under the US's more generous legal framework, vertical price-fixing is considered per-se anticompetitive.[37] Recommended retail prices and maximum retail prices are permitted in most jurisdictions as long as they do not constitute in reality a fixed or minimum price,[38] but indirect forms of price maintenance or supportive measures taken by some parties, such as fixing a price margin for the franchisee or granting benefits for following the recommended retail price (or threatening with termination if the franchisee does not follow the recommended retail price) can constitute impermissible conduct and place franchisors at risk for fines. Given the wide variety of antitrust restrictions from market to market, it may not always be crystal clear under the target country's law whether a franchise agreement provision will be deemed anticompetitive. Franchisors must seek guidance from qualified local counsel to develop a thorough understanding of regional competition regulations and take utmost care to comply assiduously with those regulations in day-to-day franchisor-franchisee interaction.[39]

2.2 Monetary, Tax, & Other Economic Considerations. A key consideration in expansion is the state of the economy in the target country (e.g., developed or emerging).[40] The capital market may be developed, with bank loans readily available to encourage economic expansion, or there may be a lack of financing infrastructure, limiting development.[41] The target market may have high rates of interest or inflation, or a scarcity of hard currency or relevant commodities.[42] The taxation structure in the country is also a critical factor. For example, the existence of a favorable corporate tax rate or a significant difference between the effective rates upon dividends as compared to royalties are important factors to consider as the franchised

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36 *See generally* VBER; TFEU art. 101.

37 *See Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752 (1984).

38 *See, e.g., State Oil v. Khan*, 522 U.S. 3 (1997).

39 *See, e.g.,* Guidelines on Vertical Restraints § 190(b).

40 Cooperative forms of market entry are preferable in developing regions, where the absence of fully functioning markets forces foreign franchisors to rely on local partners' expertise in navigating informal economic infrastructure. *See* Richard C. Hoffman, Jonathan Munemo & Sharon Watson, *International Franchise Expansion: The Role of Institutions and Transaction Costs*, 22 J. OF INT'L MGMT. 101, 103 (2016).

41 "Mexico is a difficult country to do business in – Bank loans are almost nonexistent. To build a restaurant, the investor must have cash." C. Dickinson Waters, *U.S. Chains See Brighter Days in Mexico*, NATION'S RESTAURANT NEWS (July 31, 2000). *See also Chinese Banks Rated Bottom of Moody Class*, 145 THE BANKER, no. 836, Oct. 1995, at 87 (discussing Chinese banks' postponement and renegotiation of credit contracts where Western commodity imports are involved).

42 In Venezuela, whose current economy is marked by shortages and runaway inflation, international franchisors rely on the adaptability of local partners to stay afloat, taking advantage of local solutions like franchise-affiliated credit programs and resourceful ingredient substitutions. J.P. Carroll, *Venezuela: The Challenge of Advocacy in a Collapsing Country*, FRANCHISING WORLD (Sept. 2017).

structure will impact the business's revenue stream.[43] Another key consideration is whether the franchisor's home country has a double-taxation treaty with the target country – the applicability of international tax arrangements will depend on the relationship structure,[44] including whether the franchisor will establish a local presence, or "permanent establishment," abroad.[45]

2.3 Franchisee Profile. The pool of prospective franchisees will also vary significantly depending on the target jurisdiction. Individual franchisees range from sophisticated, experienced businesspeople, conversant in international business languages and having high access to capital[46] to individuals with more limited experience and resources. There may be sociocultural norms that are particularly conducive to franchise success,[47] or there may be sociocultural barriers to overcome.[48] Many international entities find it especially efficient to work with local partners that already have an established setup for manufacturing, distribution, and marketing, through which the incoming franchisor can access market opportunities directly. In certain markets, prospective franchisees may even include state-owned enterprises, or businesses openly or quietly funded by a sovereign equity fund or other state financing source – this may have benefits, present challenges, and complicate dispute resolution in local courts.[49] Differences in business ethics and anti-corruption practices are also crucial because franchisees' compliance may have a spill-over effect on the franchisor's business in its home country as well as the target market.[50]

2.4 Receptivity to Product. For some franchisors, international expansion is a response to already-existing consumer demand for the franchised business, but other franchisors are seeking to cultivate interest in a new consumer group. Sociopolitical factors impacting public

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43 Lee J. Plave, *Ch. 1: Deciding to Go International: Organizational and Business Considerations*, in *Fundamentals of International Franchising* 14 (Am. Bar Assoc., Will K. Woods, ed., 2d ed. 2012) [hereinafter "ABA Fundamentals of International Franchising"].

44 Jenny Buchan, *Deconstructing the Franchise as a Legal Entity: Practice and Research in International Franchise Law*, 21 J. OF MKTG. CHANNELS, no. 3, 2014, at 149 (discussing the transfer pricing implications of franchise relationship structure).

45 Tao Xu et al., *Tax Issues in International Franchising*, 13 INT'L J. OF FRANCHISING L. 4, at 9 (2015)

46 Most franchisees in Saudi Arabia, for example, "are from strong, wealthy groups who can open several branches without trying to sub-franchise." Samir Ali, *Franchising's Appeal: Market Growth in Saudi Arabia*, FRANCHISING WORLD (Nov. 2008).

47 *See* Jawaid Ahmed Qureshi et al., *Mitigating Risk of Failure by Expanding Family Entrepreneurship*, 3 INT'L J. OF EXPERIENTIAL LEARNING & CASE STUDIES 110, 123 (2018) (finding the Pakistani norm of entrepreneurial families increased successful international franchise expansion).

48 Cultural variables like uncertainty avoidance and collectivism may impact the availability of suitable franchisees. *See* Maria Jell-Ojobor & Josef Windsperger, *Internationalization of Franchise Networks* in *The Handbook of Research on Franchising* (Frank Hoy, Rozenn Perrigot & Andrew Terry, eds., 2017).

49 *See* Vincent C.S. Heung, Hanquin Zhang & Chen Jiang, *International Franchising: Opportunities for China's State-Owned Hotels?*, 27 INT'L J. OF HOSP. MGMT. 368 (2008).

50 *See* Rachel Isaacson, *Managing Acquisitions Compliance in International Franchise Expansion*, 93 Denv. L. Rev. 385 (2016).

opinion can generate either acceptance of or resistance to the entry of foreign businesses into the target market.[51] Depending on cultural factors in the target market, certain elements of the franchise business model may need adjustment to accommodate local demand and tastes, colloquially referred to as "glocalization."[52] The diversity of the local market often presents complex cultural, linguistic and socioeconomic issues that make it more beneficial for a local partner to play a key role in terms of understanding the intricacies of the local market.[53] Moreover, high market saturation or competitive pressure in the region for the industry may make a strong local influence necessary to increase brand demand.[54]

2.5 Supply & Distribution. If the ingredients or supplies the franchise system needs are not available in the target region, franchisees may need to import or manufacture what they need. This factor may overlap with that of economic certainty to impact sourcing decision-making for franchisors, highlighting the need for an adaptable local presence.[55] Possible ethical sourcing difficulties may also be a consideration, and franchisors must ensure that local sourcing is compliant with the brand's ethical guidelines and with applicable laws.[56] Franchisors must also be aware of direct state interventions in the market – in jurisdictions where key resources are government-controlled, pricing and other business practices may favor domestic business entities

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51 In a study of Indian consumer knowledge and perceptions of brand country of origin found correlations between socioeconomic class and receptiveness to foreign brands but noted the tangible importance of deference to local culture. Audesh K. Paswan & Dheeraj Sharma, *Brand Country of Origin (COO) Knowledge and COO Image: Investigation in an Emerging Franchise Market*, 13 J. OF PROD. & BRAND MGMT., no. 3, 2004, at 147.

52 Before entering the Indian market, McDonald's spent 6 years learning consumers' preferences and adapting its menu accordingly. Eric Shabshelowitz, *Opening for Business in India: Retailers' Options*, 31 SUFFOLK TRANSNAT'L L. REV. 165, 181 (2007). *See also* Kerry Green, Lee Plave & Frank Robinson, "Taking International Franchising to the Next Level," Presentation at the International Franchise Association's 49th Annual Legal Symposium (May 2016) (focusing on the concept of "glocalization").

53 The greater the idiosyncrasy of the foreign market, the greater the need for strong local partners. *See* Jell-Ojobor & Windsperger, *supra* note 3, at 818. (finding that low control relationship structures led to more successful outcomes where significant sociocultural differences existed between target market and franchisor's home market).

54 In 1990's Singapore, the market dominance of McDonald's and Pizza Hut proved insurmountable for late arrivals Wendy's and Domino's, forcing them to withdraw from the region entirely. By contrast, *Swensen's*, an ice cream chain relatively unknown in its home market in the U.S., thrived in Singapore through its local operator's aggressive marketing strategy. Devin Kimble, *Barriers and Opportunities in Singapore*, CORNELL HOSP. Q. (June 1, 1996).

55 *See* Min Ju et al., *Concurrent Sourcing Strategy of Multinational Firms in China: Drivers and Performance Implications*, 54 J. OF WORLD BUS., no. 6, at 7 (2019) (finding an aggregation of benefits associated with concurrent sourcing in uncertain markets, not the least of which is a defense against opportunistic local suppliers).

56 Local perceptions on questionable practices (such as forced labor and conflict mineral sourcing) may diverge from those of franchisor. *Cf*. Joyce G. Mazero & Leonard H. MacPhee, *Setting the Stage for a "Best in Class" Supply Chain*, 36 FRANCHISE L.J. 219, 228 (2016).

over outsiders where not precluded by international law.[57] Protectionist regulations may also dictate sourcing permissibility.[58]

2.6 Geographical Proximity & Franchisor's Experience Level. The geographic proximity of the target market to the franchisor's home market is another factor to consider. Depending on distance, franchisors may be able to use existing company infrastructure to facilitate franchise support. Proximity can also be associated with sociocultural homogeneity, meaning that franchisors can apply their domestic knowledge to the new market without the need for significant local adaptation.[59] Similarly, the length and depth of the franchisor's experience in the target market is another relevant factor for consideration. Where a franchisor is relatively new to international marketing, or else relatively unfamiliar with the idiosyncrasies of the region, it will likely need to rely heavily on local partners for a successful integration.[60]

3 Options for Structuring an International Franchise Relationship

3.1 Direct Unit Franchising In a direct franchising agreement, the franchisor contracts directly with its franchisees to develop the franchise system in the target market. The franchisor, by virtue of being a party to each franchise agreement, is entitled to directly enforce those agreements and to collect system revenues without first dividing them among intervening parties, but providing direct services entails higher operating costs and the risks attendant to direct operation of businesses. The target markets which most lend themselves to direct franchising are often those most proximate to the franchisor's country of origin. Geographic proximity and established supply and distribution lines facilitate franchisors' high level of control in direct franchising by enabling them to simply extend a highly standardized existing system into the new market and provide support directly from existing domestic facilities. In regions with sociocultural and legal norms that are substantially homogenous with the franchisors' home country, franchisors can apply their own institutional knowledge without having to rely heavily on local

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57 State control of materials and resources can result in pricing and business practices that favor domestic over foreign business entities where not precluded by international law. Sean Miner, *Chapter 19 – Commitments on State-Owned Enterprises* in *Assessing the Trans-Pacific Partnership* (Jeffrey J. Schott & Cathleen Cimino-Isaacs, eds. March 2016). *See also* Raphael de Kadt & Charles Simkins, *The Political Economy of Pervasive Rent-Seeking*, 115 THESIS ELEVEN 112, 113 (2013).

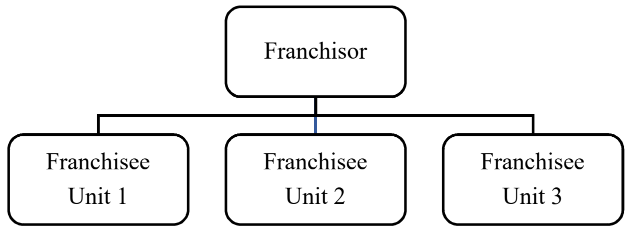
58 Where foreign franchisors establish joint ventures with Chinese state-owned enterprises, they are generally obligated to localize production and sourcing. *See* Elizabeth J. Drake, *Chinese State-Owned and State-Controlled Enterprises: Policy Options for Addressing Chinese State-Owned Enterprises*, U.S.-CHINA ECON. AND SEC. REV. COMM'N (Feb. 15, 2012). Moreover, discriminatory import restrictions in the guise of consumer protection regulations may force franchisors to rework existing supply lines and establish new relationships with local suppliers. Lionel Fontagné et al., *Product Standards and Margins of Trade: Firm-level Evidence*, 97 J. OF INT'L ECON. 29, 31 (2015).

59 *But see* note 62, *infra*.

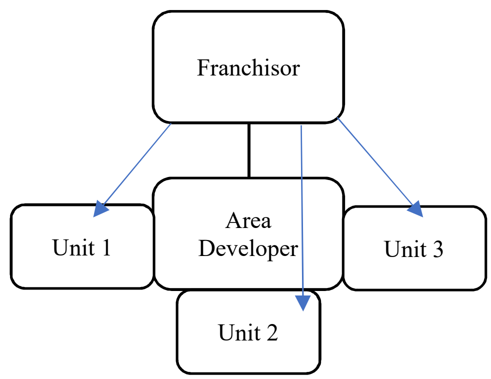
60 "After a period of local learning and familiarization with the host market characteristics, local operations and routines become less specific and heterogeneous to the franchisors, who hence become less dependent on the region-specific knowledge of the [local] partners." Jell-Ojobor & Windsperger, *supra* note 3, at 834.

business partners.[61] Nevertheless, no two markets are identical: assumptions of market homogeneity can be costly misjudgments for franchisors.[62]

3.1.1 Direct Single-Unit Franchising. A direct franchise system involves an individual direct contract between franchisor and franchisee to operate a single unit franchise. This type of relationship is typical of the overwhelming majority of domestic franchises in the United States, because (in the domestic context) it represents a limited investment for franchisees. In the international context, however, direct unit franchising may present different challenges. Moreover, establishing individual franchised units is often the slowest form of international expansion.[63] Because of the often low investment associated with the ownership and operation of a single franchised location, this structure often resonates with less sophisticated, low-capital franchisees, and is not as attractive to more experienced players (who may, nevertheless, propose a multi-unit arrangement, as noted below). Additionally, the direct franchisees likely require more training, business assistance, and oversight from the franchisor. However, those are not universal obstacles across all sectors; for example, large-scale hotel and restaurant operations typically attract experienced industry professionals or large, well-capitalized firms.[64]



3.1.2 Direct Multi-Unit Franchising (Area Development Agreements). In a multi-unit agreement, the franchisor contracts directly with a franchisee (sometimes referred to as a "developer") to establish multiple franchised units in a specified area. Two contractual relationships are formed, the first of which is the area development agreement itself, in which the franchisor grants the area developer territorial rights to develop franchised businesses, frequently with a certain degree of "exclusivity." The second relationship is between the franchisor and the franchise entity that operates the individual franchised units under unit-by-unit franchise agreements.[65]



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61 Mark A. Kirsch & John H. Pratt, *Ch. 7: International Franchising*, in *Fundamentals of Franchising*, 297 (Am. Bar Assoc., Rupert M. Barkoff et al., eds., 4th ed. 2015).

62 Underestimation of challenges (including among others cultural and legal differences) made the Canadian forays of U.S. companies *Target, Kmart, Sam's Club, Sears* & *Big Lots* short and marked by heavy losses. David Humphrey, *Canada: Similar, Not the Same*, FRANCHISING WORLD (May 2018).

63 *See* Kirsch & Pratt, *supra* note 61, at 297.

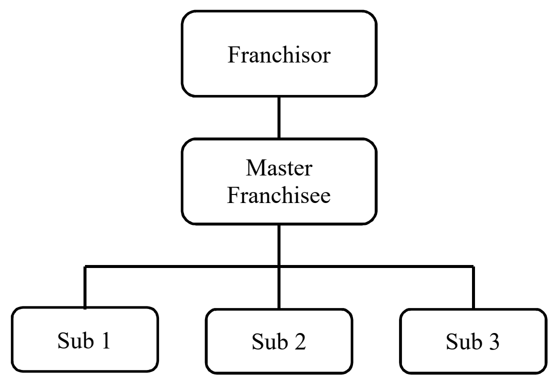
64 *See ABA Fundamentals of International Franchising*, *supra* note 43, at 9.

65 *See ABA Fundamentals of International Franchising*, *supra* note 43, at 14.

In exchange for the territorial development rights, the area developer agrees to satisfy a development schedule, opening and operating a predetermined number of units within the agreed-upon time frame. Setting a feasible development schedule can be challenging even in the domestic context; doing so in international development becomes even more of a complicated undertaking where the market potential is not yet proven to either the franchisor or the developer. One prudent approach to the development schedule is to grant developers a small territory to ascertain feasible growth and profitability targets before expanding the developer's area (possibly through an option to develop additional units in a broader area if the developer meets certain benchmarks in the initial territory).[66] However, optimism, desire to gain bargaining power over franchisees, and pressure to compete with industry counterparts already established in the territory often cause franchisors to insist upon overlarge development commitments. Overestimation of market potential bears a causal association with lower enterprise survival rates, but can be mitigated where the agreements allow for renegotiation, or where the parties gravitate to that option.[67]

The typical franchisee profile will differ considerably depending on the size and nature of the area designated for development. In larger area systems, in which development rights are awarded for an entire target market (sometimes an entire country), developers tend to be large enterprises with established success in the industry. These developers often have access to capital and substantial business sophistication, and the franchisors' costs associated with financing, training, and monitoring them are reduced. In small area systems, however, the developer profile may align much more closely to that of the single-unit franchisee.[68]

3.2 Master Franchise Agreements. In a master franchising agreement, the franchisor grants to the master franchisee the right to develop a defined area,[69] including the right and obligation to recruit subfranchisees and enter into franchise agreements with them as subfranchisor. Master franchising is a common approach taken by many U.S. franchisors in international markets, largely because it can shift to the master franchisee the burden of implementing the franchised business in the target market.[70]



A master franchise agreement departs from the direct franchise agreement structure primarily in the degree of control retained by the franchisor. Insofar as the master franchisee actually owns and operates franchise locations, the franchisor

66 *Id.*

67 Arturs Kalnins, *Overestimation and Venture Survival: An Empirical Analysis of Development Commitments in International Master Franchising Ventures*, 14 J. OF ECON. & MGMT. STRATEGY 933, 948 (2005).

68 *See ABA Fundamentals of International Franchising*, *supra* note 44.

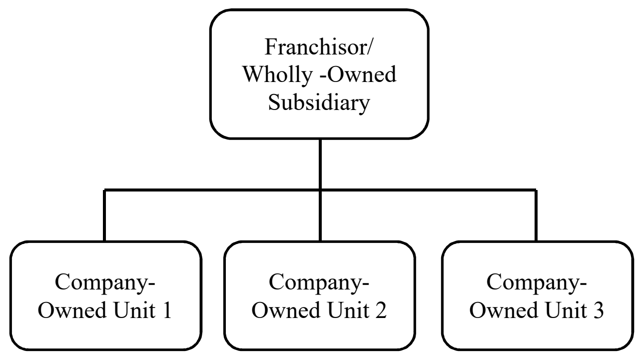
69 Development schedules are used in master franchise agreements as in area development agreements; *see* § 3.1.2, *supra*.

70 Kirsch & Pratt, *supra* note 61, at 296.

maintains control through direct contract privity. For subfranchised locations, however, the contractual relationship is typically only between master franchisee and subfranchisee, and accordingly, the master franchisee retains some residual decision rights in the region.[71]

The master franchise model demands a master franchisee with resources, experience, and sophistication sufficient to facilitate full development and support of the franchised system in the target market. While master franchisees are frequently large enterprises or seasoned industry professionals, especially in larger area systems, even the most sophisticated master franchisee still needs training in the particular business practices of the franchise system. Franchisors must also address the new possibility that master franchisees will establish subsidiaries, affiliates, or joint ventures for the ownership and operation of their direct-owned franchised units. Given that many franchisors pursue master franchise structures out of a desire to limit the number of parties with whom they are dealing, this complication can be undesirable.

3.3 Company-Owned Units. Where a franchisor wishes to retain control over the business units in the target market, it may either establish company-owned units directly or through a foreign wholly-owned subsidiary. Company ownership may entirely eliminate behavioral uncertainty factors, including the risk of opportunistic conduct by franchisees,[72] and ensures high franchise product and service quality standards (subject to employees' execution of the brand).[73] Depending on the franchisor's industry, strict conformity with aesthetic or other standards can be vital to brand establishment in a new market.[74] Company-owned units are also invaluable as pilot stores and training facilities, due to their consummate conformity with company standards.[75]



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71 Maria Jell-Ojobor & Josef Windsperger, *The Choice of Governance Modes of International Franchise Firms – Development of an Integrative Model*, 20 J. OF INT'L MGMT. 153, 159 (2014).

72 Free-riding tends not to be a problem in company-owned outlets because store managers are usually unable to reap the cost savings from skipped service expenses. Scott Shane, *Explaining the Distribution of Franchised and Company-Owned Outlets in Franchise Systems*, 24 J. OF MGMT. 717, 720 (1998).

73 *See* Jell-Ojobor & Windsperger, *supra* note 3, at 864.

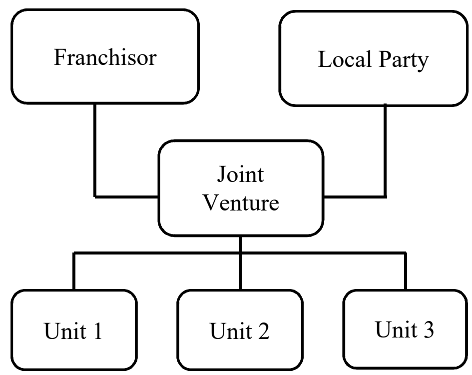
74 *See, e.g.*, Kristi Storemark & Jonas Hoffman, *A Case Study on the Business Model of Chloé*, 3 J. OF GLOBAL FASHION MKTG. 34, 39 (2012).

75 Company-owned stores' usefulness as training models becomes relevant as franchisors pluralize their relationship structures, perhaps into direct unit franchises. *See* Gérard Cliquet & Jean-Philippe Croizean, *Towards Plural Forms, Franchising/Company-Owned Systems, in the French Cosmetics Retail Industry*, 30 INT'L J. OF RETAIL & DISTRIB. MGMT. 238, 243 (2002).

Although franchisors must invest in these operations, they do of course capture the locations' full revenue rather than a percentage royalty.[76]

While it may seem as though a high level of control would be preferable in an unfamiliar market, and although 100% revenue share may seem preferable to 5%, the costs of establishing operations, engaging staff, and monitoring unit locations from a distance can be high. Moreover, having a permanent establishment in the target country may also subject the franchisor to local taxation.[77] Franchisors must weigh all of these factors, balancing the costs of establishing and maintaining company ownership against the benefits of direct ownership and control.[78]

3.4 Joint Ventures. In a joint venture, the franchisor and a local entity in the target country undertake jointly to form a separate entity for purposes of executing franchise development in the region. The parties each hold an equity interest in the entity, and the proportions of the parties' respective interests can vary significantly depending on the bargain of the parties and the legal and economic realities of the market. The franchisor typically grants a master franchise agreement to the joint venture entity (in which it holds a proprietary stake), retaining a level of direct control proportionate to its interest. In this sense, the joint venture represents something of a compromise between the relinquished control of a master franchisee relationship and the retained control of a subsidiary.



The role of the joint venturer will vary depending on the nature of the target market. If the purpose of the joint venture is merely to satisfy local ownership requirements, the local party may have a limited role in the running of the franchise system. Conversely, joint venture partners, like master franchisees, can often play an enormous role in adapting the franchise system to local commercial custom and market conditions applying their regional knowledge and influence.[79] Subject to individual bargaining and to ownership percentage requirements that may apply under law in the target country, franchisors may increase their ownership interest and control level proportionately with their experience in the foreign markets.[80]

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76 *Cf. ABA Fundamentals of International Franchising*, *supra* note 43, at 9.

77 Xu et al., *supra* note 45, at 9.

78 Scott Shane, *Explaining the Distribution of Franchised and Company-Owned Outlets in Franchise Systems*, 24 J. OF MGMT. 717, 720 (1998). *See also* Gérard Cliquet & Jean-Philippe Croizean, *Towards Plural Forms, Franchising/Company-Owned Systems, in the French Cosmetics Retail Industry*, 30 INT'L J. OF RETAIL & DISTRIB. MGMT. 238, 239 (2002).

79 *ABA Fundamentals of International Franchising*, *supra* note 43, at 19.

80 Sixt Rent A Car Inc. increased its equity interest in its Singapore franchise development joint venture from 65% at initial venture outset to 88% as its region-specific knowledge increased over time. Jell-Ojobor & Windsperger, *supra* note 3, at 834.

4. Potential Advantages and Drawbacks of Joint Ventures as Compared to Other Structures

Joint ventures offer advantages relative to the structure of a subsidiary or branch office because they allow the franchisor to integrate its JV partners' local industry knowledge, methods, and distribution networks and assimilate quickly to the new market.[81] Increased control, reduced capital investment, reduced risk, local entity status, and the potential for favorable tax treatment are some of the factors that make joint venture relationships attractive expansion structures. However, entity complexity and increased exposure to regional cartel prohibition laws and regulations are factors that may detract from joint ventures' benefits.

4.1 Potential Advantages

4.1.1 Control. In a traditional franchise system, the degree of control that a franchisor has over its franchisee, is, in principle, limited by the contractual terms in the franchise agreement and the practical nature of the franchisor-franchisee arms-length relationship. Many franchise relationships fall apart due to control issues – too much control desired by the franchisor juxtaposed against the franchisee's general preference for a free hand. Franchisors can seek to establish brand control through their franchise agreements, establishing exacting brand standards and retaining extensive rights to inspect, control, and supervise franchisees, but franchisees may balk at controls they perceive as excessive. Although franchisees do generally stand to benefit from the opportunity to capitalize on and leverage the franchise intellectual property, branding, business system, marketing strategies, etc., they also invest heavily, especially during the initial stage of setting up the business, and consider their franchises their own businesses.

In a joint venture, the franchisor can retain a measure of joint control over its international enterprise through the contractual relationship with its local joint venturers and, at the corporate level, through the shareholders' agreement. Depending on the franchisor's equity interest and voting rights, a joint venture franchisor may have a board seat and other levers that allow the franchisor to assert a greater degree of control. Members of a joint venture have statutory and contractual rights proportionate to their shareholding in deliberations over business growth, strategy, etc. The franchisor is still obliged to transfer certain of its know-how pursuant to the franchise agreement, but the joint venture structure usually places the franchisor in a position to more closely and easily monitor how that know-how is used in practice. High levels of franchisor control can be particularly advisable where there are high levels on institutional uncertainty and limited formal protections for businesses, to mitigate the increased risk of "brand hijacking" and other harmful practices.[82] The magnitude of this risk can dictate the franchisor's bargained-for ownership interest in the joint venture.[83]

4.1.2 Shared Resources, Shared Risk. The basis of a joint venture stems from the sharing and pooling of resources and competencies for a specific business purpose. Parties

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81 *See* Hufei Ge, Silu Chen & Yujie Chen, *International Alliance of Green Hotels to Reach Sustainable Competitive Advantages*, 10 SUSTAINABILITY, no. 2, 2018, at 4.

82 *Id*. at 853.

83 *Europcar's* franchise development scheme in Asia adopted different control proportions in Singapore and in China due to differences in institutional uncertainty. *See* Jell-Ojobor & Windsperger, *supra* note 3, at 819.

come together synergistically, leveraging their respective competencies, knowledge, and resources to achieve their mutual business objectives, and the business purpose is often much wider in scope than a conventional grant of rights to use the intellectual property of the franchisor and sell products. The availability of the local partner's business infrastructure, knowledge, and supply and distribution networks can drastically reduce the drain on franchisor resources that generally accompanies a solo foray into a new market, and the local partner's capital contributions obviously constitute proportional relief for the franchisor. A joint venture partner shares responsibility for profits and losses per the pre-determined ratio and may participate in the day-to-day operation of the franchise system. By sharing the equity ownership or financial commitment in the form of loans or convertible bonds, and by pooling resources for operating the joint venture entity, the franchisor and local partner both contribute significantly to successfully launch and sustain the business, and may benefit significantly thereby.

4.1.3 Regional Entity Status. There may also be advantages to having a domestic corporate form for incoming franchisors who opt for the joint venture. As noted above,[84] many jurisdictions have restrictions on the business conduct of foreign entities and persons, including formal rules, such as foreign direct investment regulations, and less formal practices, such as delays in processing regulatory agency filings for foreign nationals. The local entity may also act as a host for the purpose of obtaining visas and work permits to the personnel of the foreign franchisor being dispatched to the area for management or training.

4.1.4 Tax Benefits. Although recent efforts to close international taxation loopholes have somewhat hampered multinational entities' tax planning efforts,[85] there still may be tax benefits to be reaped from the international joint venture structure. Under the applicable tax treaty with the target jurisdiction, the (reduced) tax rate for dividends and royalty/franchise fee could be different. Therefore, provided that any transfer pricing issues have been addressed, the franchisor could benefit from lowering its tax liability by strategically structuring its target market-sourced income (dividends and royalty/franchise fee) in a manner that is most tax efficient. Certain tax-planning methods, such as the use of a "blocker" corporation to hold the franchisor's interest in the joint venture, can help franchisors to avoid the "permanent establishment" implications of a joint venture entity and the tax consequences therefrom.[86]

4.2 Potential Drawbacks.

4.1.2 Entity Complexity. One drawback with the joint venture route may be the burdensome procedure of setting up a new entity. The necessity of statutory license registration and compliance with regional laws and regulations for corporate formation can increase the risks and costs of doing business in a new jurisdiction. The formation and execution of a water-tight joint venture shareholders' agreement can also be an onerous task, but its importance cannot be understated – a well-constructed joint venture agreement can provide ways for joint venture partners to resolve and even deter disputes that could arise at the level of the franchisor-master

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84 *See* § 2.1.4, *supra*.

85 Initiatives attacking base erosion and profit shifting (BEPS) led by the Organization for Economic Cooperation and Development (OECD) have caught on with tax authorities worldwide. Michael Lebovitz & Stephen Weerts, *M&A and BEPS: Managing for new uncertainties and risks*, INT'L TAX REV. (Mar. 18, 2016).

86 Xu et al., *supra* note 45, at 13.

franchisee relationship. Certain mechanisms should be built into the joint venture agreement to reduce the risk of a dispute between the joint venture partners, including procedures for disagreements over management structure or operating funds. Where intellectual property rights are transferred to the joint entity, the joint venture agreement must also stipulate terms for their management during the entity's existence and their return/deregistration at its termination. Parties must negotiate special rights relating to the minority partner's shareholding such as board representation, anti-dilution, preemptive rights, and affirmative voting rights besides building in effective deadlock resolution mechanisms aimed at swift and, as far as possible, discreet resolution. Exit options (such as strategic third party sale, M&A, buy-back, drag/tag rights and call/put options if a deadlock occurs) have to be well etched out, and there must be detailed valuation methodology for exiting shareholders.

In the event of a deadlock among joint venturers, there are practical challenges in exiting the venture and winding up the entity. These challenges arise in part because the relationship is bound by at least two principal agreements: (1) the (master) franchise agreement executed between the franchisor and the joint venture entity; and (2) the joint venture agreement (*e.g..,* shareholders agreement) among the joint venturers. Unlike in a traditional franchise arrangement, the contractual relationship between the joint venture partners cannot be terminated simply by terminating the (master) franchise agreement: there is the added layer involving the joint venture agreement. Thus, even in case of a dispute among the franchisor and the franchisee, the joint venture relationship between the joint venture parties would continue – and consequently, the franchise business – throughout the dispute resolution process. In order to terminate the franchise relationship, the joint venture members must also terminate the joint venture agreement and carry out the winding-up of the joint venture entity. This significant legal (and regulatory) step would weigh against terminating the franchise relationship governed by the agreements. As such, there are practical challenges in exiting the joint venture and winding up the joint venture entity in the event of a falling-out of the joint venture partners. In many jurisdictions, winding up a corporate entity is an arduous process, requiring extensive documentation and the expenditure of time and therefore money.

In addition, although forming a separate joint venture entity may result in favorable tax treatment for franchisors, the resulting corporate complexity can make the tax filing process more burdensome. Under some jurisdictions' tax or corporate laws (as well as national Generally Accepted Accounting Principles), the joint venture's financials may have to be consolidated into the franchisor's financial statements where the franchisor exercises substantial and *de facto* control over the joint venture entity.

4.2.2 Antitrust Regulation. Another major potential drawback to the joint venture structure in international franchising is that it may subject franchisors and their prospective joint venture partners to cartel prohibition enforcement under regional antitrust laws.

In some jurisdictions, including South Korea, [87] China, and the European Union,[88] the creation of a new franchise joint venture in which the franchisor and its local partners set up a legal entity under joint control may constitute a "concentration" and therefore fall within the scope of regulatory merger control. If so, then a notification and filing with the regional trade commission is mandatory, subject to potential fines and other sanctions for noncompliance. In the EU, a notification to the European Commission is required if the franchise joint venture will operate as a 'full-function undertaking' and if it has autonomous presence on the EU market.[89] Even a franchise joint venture that does not operate as a 'full-function undertaking' will need to self-assess to ensure compliance with the general antitrust restrictions.[90]

4.2.2.1 *Full-function undertaking.* To be 'full-function,' the franchise joint venture must: (i) have a management dedicated to its day-to-day operations and access to sufficient assets, personnel and financial resources in order to operate its business activity independently; (ii) have the ability to conduct its own commercial policy; (iii) have activities that go beyond one specific function for the parents; (iv) have no significant purchase or supply agreements between it and its parent that would undermine its independent character; and (v) be of a sufficiently long duration as to bring about a lasting change in the structure of the undertakings concerned.[91] A joint venture is not full-function if it only takes over one specific function within the parent companies' business activities without its own access to or presence on the market.[92] A joint venture that only maintains buying relationships with the parent companies will not qualify as an autonomous economic entity,[93] nor will a franchisee that simply fulfills a specific function for the parent companies.

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87 In Korea, a merger filing is required under the Monopoly Regulations and Fair Trade Act of Korea if: (1) worldwide sales or total assets on the consolidated basis of either one of the joint venture partner and its affiliates is KRW 300 billion (approximately USD 252 million) or more; and (2) worldwide sales or total assets on the consolidated basis of the other joint venture partner and its affiliates is KRW 30 billion (approximately USD 25 million) or more. If the worldwide sales or total assets of either joint venture partner on the consolidated basis is KRW 2 trillion (approximately USD 1.68 billion) or more, then a "pre-incorporation" merger filing is required. Consequently, the joint venture parties may not subscribe to the shares of and incorporate the joint venture without receiving the approval from the Korea Fair Trade Commission.

88 This section will focus on EU Cartel Prohibition as representative of the potential enforcement risks franchisors may face in regulation-heavy jurisdictions worldwide.

89 Council Regulation 139/2004 of Jan. 20, 2004, EC Merger Regulation, art. 3, 2004 O.J. (L 024) [hereinafter EC Merger Regulation]; Case C-248/16, *Austria Asphalt GmbH & Co OG v. Bundeskartellanwalt*, ECLI:EU:C:2017:322 (2017).

90 *See* § 2.1.6, *supra.*

91 Commission Consolidated Jurisdictional Notice, 2008 O.J. (C 95) [hereinafter Consolidated Jurisdictional Notice].

92 Consolidated Jurisdictional Notice § 95.

93 Case C-248/16, *Austria Asphalt GmbH & Co OG v. Bundeskartellanwalt*, ECLI:EU:C:2017:322 (2017); EC Merger Regulation art. 3(4).

4.2.2.2 *Community dimension.* If a franchise joint venture qualifies as a concentration, it is subject to EU merger control and must notify the concentration to the European Commission for clearance before the implementation if it has a 'community dimension'.[94] Normally, a concentration has a community dimension where the combined aggregate worldwide and EU-wide turnover of all the undertakings concerned exceeds certain threshold amounts.[95] Special rules apply to the calculation of turnovers in the case of a joint venture. Since a joint venture belongs to a group (the parents), the EC Merger Regulation takes into account not only the turnover of the joint venture itself, but also the turnover of those parents with which the joint venture concerned has direct or indirect links.[96] Thus, in the situation of a franchise joint venture, the turnover of the franchisor and local franchise partner must be included in the calculation of the turnover as they are the parties that will be exercising joint control.[97] Yet, the concentration only has a community dimension if both of the parent companies have a separate annual turnover of more than EUR 250 million each.[98] This is relevant, because often the local franchise partner is a smaller business with a lower annual turnover than the franchisor that is seeking international expansion. But even if threshold requirements are met, the franchise joint venture might not be a concentration with a community dimension if each of the undertaking concerned achieves more than two thirds of its aggregate EU-wide turnover within one and the same EU Member State ('two-thirds rule'). When considering the foregoing thresholds against the annual turnover of some of the world's largest franchisors, this may lead to the conclusion that they, as a franchisor, may indeed meet the thresholds to be subject to EU merger control since annual revenues easily

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94 EC Merger Regulation art. 1(2).

95 A concentration has a Community dimension where the combined aggregate worldwide turnover of all the undertakings concerned exceeds EUR 5,000 million and aggregate EU-wide turnover of each at last two of the undertakings concerned exceeds EUR 250 million. If the concentration does not meet the foregoing thresholds, it will nevertheless have a Community dimension where a combined aggregate worldwide turnover of all of the undertakings concerned exceeds EUR 2,500 million, or in each of at least three EU member States the combined aggregate turnover of all of the undertakings concerned exceeds EUR 100 million or in each of the least three of those same EU Member States the aggregate turnover of each of the at least two of the undertakings concerned exceeds EUR 25 million or the aggregate EU-wide turnover of each of the last two of the undertakings concerned exceeds EUR 100 million.

96 The EC Merger Regulation does not delineate the concept of a group in a single abstract definition, but sets out certain rights or powers. A direct or indirect link is to be regarded as part of a group for the purposes of turnover calculation if the parent (i) owns more than half the capital or business assets, or (ii) has the power to exercise more than half the voting rights, (iii) has the power to appoint more than half the member of the supervisory board, the administrative board or bodies legally representing the undertakings, or (iv) has the right to manage the undertaking's affairs. The EC Merger Regulation does not delineate the concept of a group in a single abstract definition, but sets out certain rights or powers. EC Merger Regulation art. 5(4).

97 Joint control exists where two or more undertakings or persons have the possibility of exercising decisive influence over another undertaking. Decisive influence in this sense normally means the power to block actions which determine the strategic commercial behaviour of an undertaking. Joint control is characterized by the possibility of a deadlock situation resulting from the power of two or more parents to reject proposed strategic decisions. Consolidated Jurisdictional Notice § 62.

98 EC Merger Regulation art. 2(b).

exceed USD 21 billion.[99] Large franchisors in the hotel sector, for example, have an annual revenue of over USD 20 billion.[100] Large franchisors in Europe, such as in the supermarket or department store business, have annual turnovers of similar or even higher amounts.[101] However, as the turnovers of the joint controlling partners should both be taken into account, the answer to the question whether a community dimension exists will very much also depend on the turnover of the local franchisee. A full-function joint venture that is located and operates outside the EEA (and that would not impact the markets in the EEA) falls outside the scope of the EC Merger Regulation. Thus, such joint ventures need not notify the EC, even if the turnover thresholds are met.

4.2.2.3 *Substantive analysis and spill-over effects.* The European Commission tests merger notifications against the question of whether the proposed venture would significantly impede effective competition in all or a substantial part of the internal market and, in particular, whether the venture would create or strengthen a dominant market position.[102] The European Commission's guidelines on horizontal mergers provide examples of concentrations that may significantly impede effective competition.[103] In concentrated markets, the joint venture may significantly impede effective competition by producing "coordinated" anticompetitive effects. In addition to this assessment, the creation of a full-function joint venture is subject to an additional substantive test to determine whether the venture's interactions with the internal market give rise to so-called 'spill-over effects.'[104] Such spill-over effects can occur if the franchisor and local franchise partner are active on the same market as the franchise joint venture or on a market that is closely related to the franchise joint venture's market.[105] Thus, a double check applies to determine: (i) whether the joint venture itself significantly impedes effective competition; and (ii) whether the coordination between the franchisor and local franchise partner (parent companies) is contrary to the cartel prohibition. To date, the European

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99 McDonald's Corporation 2018 Annual Report, https://corporate.mcdonalds.com/content/dam/gws corp/investor-relations-content/annual-reports/McDonalds_2018_Annual_Report.pdf; Revenue of McDonalds Corporation Worldwide, https://www.statista.com/statistics/208917/ revenue-of-the-mcdonalds-corporation-since-2005/.

100 Marriott International Inc., annual report 2018, https://marriott.gcs-web.com/static-files/8799734e-b9e0-4e53-b194-7bd24a381118; Marriott revenue 2006-2019, https://www.macrotrends.net/ stocks/charts/MAR/marriott/revenue.

101 SPAR annual report 2018, https://spar-international.com/wp-content/uploads/2018/05/SPARAR17 _R27_ FINAL_ SINGLES.pdf.

102 EC Merger Regulation art. 2(1)–(3).

103 Alex Nourry & Jennifer Storey, *Transactions & Practices: EU Mergers & Acquisitions*, § 25 – Horizontal Guidelines, THOMSON REUTERS PRACTICAL LAW: PRACTICE NOTES (2019).

104 EC Merger Regulation art. 2(4); Spill-over effects are examined in accordance with the criteria of Article 101 TFEU in order to establish whether the concentration is compatible with the EU internal market.

105 EC Merger Regulation art. 2(5).

Commission has never prohibited a concentration because of spill-over effects.[106] The joint venture approach to setting up a franchise network is often primarily vertical in nature, consisting of non-competing parties, one of which licenses the other the trademark and know-how to operate one or more business units in line with quality requirements, possibly including the right to sublicense. As a result, many franchise joint ventures may not in fact lead to high market shares or significantly impede trade, but exceptions may always apply. If the franchise joint venture does not constitute a concentration within the meaning of EU competition law, the joint venture will nonetheless be subject to a (self) assessment under Article 101 TFEU. First horizontal aspects will have to be assessed, then vertical aspects. Depending on the type of joint venture partners and the type and duration of restrictions, the outcome of such assessment may vary.

4.2.2.4 *Assessment of ancillary restrictions and the cartel prohibition*. It may seem logical that, as part of the transaction to establish a franchise joint venture, certain restrictions (e.g., non-compete and purchase obligations) are imposed by the parent companies on the franchise joint venture. Those restrictions are usually regarded as ancillary if they are directly related to and necessary for the implementation of the concentration.[107] For example, this may be the case when a franchise joint venture is obliged to purchase from its parents where the parents assign certain stages of the production. Other examples of ancillary agreements between the franchisor and the joint venture are non-compete covenants and IP license agreements. Such non-compete clauses are only justified when their duration, their geographical field of application, their subject matter, and the persons subject to them do not exceed what is reasonably necessary to achieve that end.[108] Such non-competition clauses reflect the need to ensure good faith during negotiations; they may also reflect the need to enable the joint venture to assimilate know-how and goodwill provided by its parents; or the need to protect the parents' interests in the joint venture against competitive acts facilitated by the parents' privileged access to the know-how. Additional restrictions regarding pricing and quantities generally go beyond what is required for establishing a joint venture. Another example of a restriction that is not ancillary is a non-compete that is extended to areas in which the franchise joint venture in the future may want to exploit its business.[109]

If the joint venture itself does not restrict EU competition law, ancillary restrictions that meet the above criteria are not caught by the cartel prohibition under Articles 101 & 102 TFEU and national competition laws.[110] The assessment of ancillary restrictions are automatically

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106 Steve Spinks & Ken Daly, *European Union: Merger Control 2019*, § 4.6, INTERNATIONAL COMPARATIVE LEGAL GUIDES (Dec. 17, 2018), https://iclg.com/practice-areas/merger-control-laws-and-regulations/european-union.

107 Commission Notice on Restrictions Directly Related and Necessary to Concentrations of Mar. 5, 2005, 2005 O.J. (C 56) [hereinafter Notice on Ancillary Restraints]; Case COMP/JOINT VENTURE.46 (*Callahan Invest/KabelNordrhein-Westfalen)*, June 19, 2000, 2000 O.J. (C 114/4).

108 Notice on Ancillary Restraints. *See also* Case 42/*84 Remia BV et al. v. Comm'n*, 1985 E.C.R. 2545, ¶ 20; Case T-112/99, *Métropole Télévision (M6) et al. v. Comm'n*, 2001 E.C.R. II-2459, ¶ 106.

109 Case IV/JOINT VENTURE.22 Fujitsu/Siemens, Sept. 30, 1999.

110 Commission Guidelines on the Application of Article 101(3) TFEU, 2004 O.J. (C 101/97); Notice on Ancillary Restraints, ¶ 7.

covered by the EC in a merger analysis.[111] Before the merger analysis by the EC, it is up to parties themselves to conduct a *self-assessment* of which restrictions are ancillary. If the restraints are not ancillary, parties will have to review whether the restrictions may fit into a block exemption regulation (e.g., VBER). If this fails, parties will have to assess whether the criteria for the application of Article 101 (3) TFEU are met in order to still escape the applicability of the cartel prohibition. Restrictions that do not fit any of the above exemptions are to be assessed separately under Article 101 TFEU.[112] Another analysis that must be carried out in regard to the question whether or not the parents – the franchisor and the local franchise partner – are competitors.

Non-compete obligations are ancillary if they are to ensure good faith during negotiations, to fully utilize the joint venture's assets, and to enable the joint venture to assimilate the know-how and goodwill transferred to the joint venture. These obligations are regarded as ancillary during the lifetime of the joint venture.[113] The same principles apply to non-solicitation and confidentiality clauses.[114] Restrictions regarding pricing usually go beyond of what is required for establishing a joint venture and thus do not qualify as ancillary restrictions.[115] Exclusivity provisions are also not ancillary,[116] but fixed-quantity purchase and supply agreements necessary to avoid the disruption of traditional purchase and supply lines within the business transferred are considered ancillary up to five years' duration.[117] Supply and purchase obligations providing for unlimited quantities are not ancillary.[118] Restrictions regarding pricing and quantities usually go beyond of what is required for establishing a joint venture and thus do not qualify as ancillary restrictions. Purchase obligations that are imposed by parent companies are regarded as ancillary if they are directly related to and necessary for the implementation of the joint venture.[119]

5. **Different Possible Joint Venture Ownership Structures**[120]

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111 EC Merger Regulation arts. 6(1)(b) & 8(1)–(2).

112 Notice on Ancillary Restraints, ¶ 7.

113 *Id*. at ¶ 515.

114 *Id*. at ¶ 41.

115 *See generally id*.

116 *Id*. at ¶¶ 32-35.

117 Notice on Ancillary Restraints, ¶¶ 32-35.

118 *Id*. at ¶¶ 34.

119 *See generally id*.

120 Among the myriad options for structuring a joint venture relationship are partnerships (both general and limited liability), pass-through hybrid entities (e.g. US S-corporations and French SCA's), limited liability companies, and contractual arrangements in which parties agree to apportion business responsibilities without forming a separate entity. This paper focuses on the general corporate joint venture in its varying forms as the most common joint venture structure. We do not undertake here to evaluate the relative merits of the aforementioned alternatives.

5.1 Capital contributions by joint venture parties (i.e.*,* shareholders' agreement). A joint venture agreement is essentially a shareholders' agreement that stipulates the joint venture partners' agreement as to the equity ownership ratio, management structure and board composition, adoption of the business plan, owner support, reporting and information access, additional financing, and exit and termination rights, among others. Generally, the equity ownership ratio of a joint venture is influenced by factors such as the prevailing foreign direct investment regulations,[121] proposed business activities, and the nature of involvement of each party, and norms vary widely across the globe. Protection of the minority equity holder could also be built in by leveling the positions of the joint venture partners and providing the minority equity holder with veto or prior-consent rights to certain designated agendas. Of course, ultimately, the equity holding ratio that each party has in the joint venture may play a large role in the degree to which either party has control (e.g., foreign franchisor: 40%, local partner: 60%). In Indian foreign partner joint ventures, for example, common share ratios are 74:26 and 51:49 as Indian company law requires board and shareholder decisions to be approved either through simple majority or three-fourths majority.

Disadvantages that could exist for the franchisor arising from a smaller capital contribution could be addressed, to some extent, by the fact that the franchisor would be contributing its know-how and providing training for the management and operations of the joint venture entity. If any disadvantages from a smaller capital contribution by the franchisor can be addressed within the joint venture agreement, then the franchisor will likely have more incentives for developing distribution network and running training programs due to its higher level of involvement. To the extent that certain types or categories of disputes could be anticipated in advance (and often is the case), the joint venture agreement (e.g., shareholders' agreement) itself would have built-in mechanisms that would allow the shareholders to circumvent potential shareholder disputes (*e.g.*, deadlock clause and Right of First Refusal to buy other the equity interest of other shareholders).

5.2 Loan Agreement with the Local Entity. In order to reduce the tax liability that may arise from having a permanent establishment or local presence in the regional market, an international franchisor may consider only making a loan to the local party (which will operate as an area developer or a master franchisee). Under this scenario, the foreign franchisor will not have any equity interest and will not hold seats on the board of the local entity. Nevertheless, to protect important commercial rights and interests for the foreign franchisor, the franchisor may consider – as the lender for the local partner – whether to reserve veto rights and prior-consent rights to an agreed set of agendas through the loan agreement.

In principle, the franchisor would receive only receive interest payments on its loan to the local partner under the loan scenario. Thus, the foreign franchisor may not able to benefit from the business success of the local operator. To address this point, the foreign franchisor may negotiate for the local party to pay a certain multiple of the principal if certain performance milestones are met. This approach, depending upon how it is structured, may require additional governmental reporting. Also, stipulating the formula of multiple as repayment can be complicated and may require special drafting of intricate provisions in the loan agreement.

5.3 Convertible Bonds Subscription Agreement with the Local Entity. The international franchisor may instead consider subscribing to convertible bonds issued by the local entity that would allow, if circumstances warrant, conversion of the bond (i.e., loan) into equity.

121 *See* § 2.1.4, *supra*.

This would eventually convert the local entity into a joint venture entity, the terms and conditions of which (e.g., conversion price and conversion period, adjustment of conversion price in case of dilution of existing shares) would be negotiated through an initial investment agreement or a joint venture agreement. Under either approach, the foreign franchisor would be able to negotiate to secure board seats and reserve veto and other rights.

So long as the foreign franchisor remains as a holder of convertible bonds ("CB Holder"), the foreign franchisor would be able to receive interest on the principal loaned to the local entity. Thus, as a CB Holder, the foreign franchisor typically would not be exposed to the risks that would exist if the foreign franchisor was an equity holder. An additional benefit of holding convertible bonds is that the foreign franchisor would be able to negotiate the conversion ratio in advance so that the foreign franchisor would be able to gain equity in the joint venture entity at below fair market value at the time of conversion. Further, if the local entity becomes unsuccessful and enters bankruptcy proceedings, the foreign franchisor as a CB Holder and unsecured creditor would have a higher priority claim than as an equity holder of the local entity.

6. Feasibility of Using Joint Venture Structures to Circumvent Regional Laws[122]

Can a joint venture structure mitigate the need to comply with underlying franchise and other transnational laws? It seems at first glance that, because of the variety of different franchise laws that contain different definitions and scope and other non-franchise specific mandatory laws with far reaching consequences, setting up a joint venture merely to avoid mandatory requirements may not be a sound choice. Rather, this must be assessed in full on a case-by-case basis.

In order to escape mandatory provisions in national laws, setting up a franchise joint venture would have the desired effect only if it does not fall within the scope of applicable mandatory requirements. Reviewing franchise specific laws requires assessing whether the franchise joint venture still qualifies as a 'franchise' in certain jurisdictions by looking at statutory or regulatory definitions of franchising. Many national franchise laws in Europe do not provide for a statutory definition of a franchise or a franchise agreement. In many situations, this follows from case law or reference is made to franchising codes developed by branch organizations, as is the case in for example Switzerland. In general it can be said that the presence of certain elements may characterize the existence of a franchise relationship: (1) the grant of the right to distribute franchised goods or services using the putative franchisor's marks; (2) the communication of specific know-how; and (3) the assistance provided to the franchisee by the franchisor.[123] In the Netherlands, a draft bill on franchise includes the following definition of a franchise agreement: "an agreement under which the Franchisor grants the Franchisee the right, for valuable remuneration, to commercialize a Franchise Formula in a designated manner for the production or sale of goods or the provision of services."[124] The draft bill on franchise also includes the definition of the franchisor and franchisee, and the franchise formula. An agreement to form a franchise joint venture may fall within the scope of a franchise agreement under this draft bill. As

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122 This section will again focus on the European Union as representative of the potential enforcement risks franchisors may face in regulation-heavy jurisdictions worldwide.

123 Gilles Menguy, *France: Overview*, THOMSON REUTERS PRACTICAL LAW: FRANCHISING GLOBAL GUIDE (Dec. 1, 2018).

124 Article 911 (f) Dutch draft bill on franchise.

stated above, in most franchise joint ventures, there will be some sort of IP licensing agreement, for which the joint venture entity will pay fees, in order for the franchise joint venture to be in effect and produce and sell goods. The absence of international clarity and the absence of harmonization of EU law when it comes to the question of what business structures fall within the scope of franchising throughout Europe, leads to the preliminary conclusion that national franchise laws could also apply if the cooperation with a (master) franchisee is set up as a joint venture.

Setting up a joint venture with a local franchise partner can be preferable over a pure (vertical) contractual relationship with a franchisee, but it seems that from a legal perspective, the pros and cons require a complex case-by-case assessment. Foreign national franchise and other mandatory laws may feel like a ‘can of worms’ in terms of unwanted surprises and complexities and there is no common definition of franchise or franchise agreement in EU law. Every jurisdiction in Europe has its own national civil laws applicable to franchise. In the EU there are relatively few statutory franchise obligations that actually limit franchisors in their opportunities and contractual freedom to expand their franchise businesses, most are ‘red tape’ that can be dealt with by taking precautions and ‘saving’ up for termination costs. Setting up a joint venture does not necessarily ‘save’ money or ‘bypass’ such issues, but it may be a prudent choice in some jurisdictions depending upon individual country analysis.

When implementing a global expansion strategy, in particular for large franchisors, the choice for a franchise joint venture may create other commercial and legal hurdles. From a competition law perspective in the EU, depending also on the size of the franchisor and franchisee, it would not necessarily be ‘easier’ to choose for a franchise joint venture.[125] Up to the present time, franchise joint ventures are not the most popular way of expanding a franchise in the majority of European countries. It is conceivable that this has to do with the hurdles of setting up a joint venture. There is no certain answer to the question why that is. In any case, there are no regulatory requirements for local ownership in the EU. It is likely that the benefits might simply not outweigh the complexities of setting up and maintaining a local joint venture.

The main question is: does a joint venture provide for a less strict environment from a competition law perspective than which is the case in traditional franchise systems? There is no general answer to this question; the answer would depend on the specific restriction. The relevant legal assessment is highly complex: context is highly relevant and a joint venture might in reality create an identical or possibly even less favorable outcome to that of traditional franchise systems in jurisdictions like the European Union.

7. Case Study: Joint Ventures & Franchises in India

While joint ventures have remained a popular option especially at the start of the business relationship, the *McDonald’s* brand story in India holds interesting lessons for businesses deciding between the joint venture and the franchise route. McDonald’s Corporation (“MCD”) entered the Indian market in 1995 by setting up a wholly-owned subsidiary, McDonald’s India Private Limited (**MIPL**), which entered into two JVs (50:50) with two local Indian companies - one to manage the Northern and Eastern part of India (headed by Vikram Bakshi) and another to spearhead its

[125] *See* § 4.2.2, *supra*.

business in South and West India respectively. This strategy was different from the much-touted franchise fee-royalty model that McDonald's adopted in most other countries.

As *McDonald's* was getting popular and outlets with Indianized menus were opening up across the country, the partnership between the fast food giant and Bakshi turned sour in 2008 after MIPL tried to buy out Bakshi's 50% stake for USD 5 million (Bakshi's initial investment in the venture way back in 1996). Bakshi refused to sell at such a low valuation and that gave rise to a long-running dispute between the two JV partners, with MIPL further alleging that Bakshi was mismanaging company funds and focusing on his other business interests. Matters took a turn for the worse in 2013 when MCD removed Bakshi as the managing director of MIDL: Bakshi challenged his removal before the Company Law Board and accused MCD of oppressive behavior. While Bakshi was eventually reinstated as the managing director in 2017, MCD terminated the franchise arrangement and took Bakshi's entity to court alleging unauthorized use of their IP after termination of the contract. The protracted legal battle between MCD and Bakshi finally ended with an out-of-court settlement in May 2019, in which MCD bought out Bakshi's full stake for an undisclosed amount, transferring full ownership and management of the JV entity back to MCD.[126] Interestingly, MCD is now reverting to its traditional franchise model of merely licensing its brand and IP in return for a fee and royalty and staying out of ownership structures in the Indian market.

This case serves to illustrate that the selection of a local partner whose interests are completely aligned with the franchisor is a tremendous challenge for a franchisor in a new jurisdiction. In a country like India where most businesses are family-run with promoters often running multiple businesses with intertwined and related party transactions, enforcing conflict of interest and non-compete obligations can be tricky. Managing control expectations with such a local partner (especially in a 50:50 shareholding ratio) and restricting unauthorized use of the franchisor's IP may not always be a smooth affair. Cross-cultural differences among joint venturers, if not handled with sensitivity and nuance, can sabotage not just the parties' relationship but also the underlying business.

While the *McDonald's* experience pointed to the inherent challenges of the JV route in India, other foreign companies have had better success in managing their Indian JVs. British fashion retailer *Marks & Spencer* first entered India through the franchise route in 2001 and formed a JV with Reliance Retail in 2008, in which the British parent owned a 51% stake. Despite the British brand's woes in the UK and other parts of the world, India has now emerged as the brand's second largest market outside UK and is continuing to expand its footprint across the country. Spain's *Inditex*, the owner of the *Zara* fashion brand, also has a JV in India with the Tata Group's retail arm, Trent Limited. Inditex, which owns 51% of the venture, recorded a 73% growth in net profit for 2017-18. The American coffeehouse chain, *Starbucks*, entered into a 50:50 JV with Tata Global Beverages in 2012 and has been growing at a steady pace since then.

On the franchise front, *Subway* with its direct franchise model and *Domino's Pizza* through a master franchise structure have been success stories in the 'quick service restaurant' and fast

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126 *See* Harveen Ahluwalia, Livemint, *Inside the McDonald's-Vikram Bakshi Controversy*, LIVEMINT (Dec. 29, 2017,); *see also Vikram Bakshi is finally out, and McDonald's India is lovin' it*, THE ECONOMIC TIMES (May 14, 2019).

food category. Other brands including *Baskin-Robbins*, *Clarks International*, *Dunkin' Donuts*, *KFC*, *Jockey*, and *Taco Bell* have also gained a foothold in India through the franchise route.

8. Conclusion

For an international franchisor expanding into a new region, navigating through the plethora of factors that differentiate each market from the next can be a formidable challenge. With these factors in mind, and with the aid of experienced legal and business advisors, the franchisor must choose from among various structure options, including company-owned operations, master franchising, multi-unit franchising, direct unit-by-unit franchising, and joint ventures (JVs) between the franchisor and local parties. The joint venture may afford certain advantages in the international sphere when compared with alternative structures, but requires careful consideration of numerous business and legal factors and disciplined execution to ensure success and to minimize exposure. Of course, franchisors can negotiate with their local joint venture partners to tailor the ownership structure of the venture to their specific needs. However, the joint venture is not a one-size-fits all solution, and danger awaits the franchisor that fails to conduct a full individual analysis of its own characteristics and those of its potential joint venture partners, as well as the political, economic, and sociocultural environment of its target market.

BIOGRAPHIES

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Martine de Koning is a partner in the International Commercial practice group of the Dutch law firm Kennedy Van der Laan, based in Amsterdam. She counsels corporate business entities on international expansion and franchising, and handles international disputes on intellectual property, commercial contracts, and anticompetitive practices.

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