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CHAPTER 9

Inbound Transactions: Introducing a Non-U.S. Franchise Program to the United States

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I. Introduction

There are a number of considerations that are crucial to entry into the U.S. market. They range from tax considerations to regulatory requirements including some thorny disclosure and registration issues.

II. Preparing to Enter the U.S. Market

A. Intellectual Property Protection

It is critical that non-U.S. entrepreneurs and businesses have a basic understanding of the different areas of U.S. intellectual property laws that might apply to their goods and services. As with U.S. businesses entering other jurisdictions, it is important to secure the assistance of a knowledgeable intellectual property lawyer in the United States early in the process.

1. Trademarks

In the United States, trademark rights arise from commercial use of distinctive names, words, symbols, and logos on or in connection with goods or services distinguishing the source of those goods or services. Trademark rights can also be accorded sounds, smells, colors, and shapes in certain limited instances. U.S. trademark law is designed to prevent customer confusion, mistake or deception as to the source, affiliation, or sponsorship of goods and services.

For example, when consumers buy brand-name products, they know these products come from a certain source even if the consumers do not know the name of the source. Consumers may also come to expect a certain quality associated with the brand. If another party later begins using a similar name for similar items, consumers could be confused as to the source of the products.

When a party from outside of the United States wants to bring its branded products or services into the United States, or if it wants to develop a new product or service for the U.S. market, it should first determine whether or not there is any negative connotation or meaning for the mark in the United States. A clearance search should be performed, which typically entails a quick screening search of just the federal register to determine if there are any marks that are so similar that it would be futile to pursue the registration of the mark (known as

"knockout references"). If the proposed mark appears available, a more comprehensive search should be made. This search involves obtaining an outside vendor to produce a detailed search report. U.S. trademark counsel then typically analyzes the results of the search and provides a report regarding whether or not an application for federal registration is recommended.

If the proposed mark appears to be clear for use and registration, parties that intend to use the mark on a widespread basis, such as franchisors, typically choose to file for federal trademark registration. In the United States, a party may file an application with the U.S. Patent and Trademark Office (USPTO) for trademark registration based on intent to use the mark or based on actual commercial use of the mark. Once obtained, a federal registration provides legal benefits beyond the simple common-law trademark rights that accrue through commercial use, including presumptive nationwide priority as of the filing date.

Whether or not the non-U.S. party's home country is party to a convention such as the Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks (the Nice Agreement), the International Convention for the Protection of Intellectual Property (the Paris Convention) or the Madrid Agreement Concerning the International Registration of Marks (the Madrid Protocol) may affect the manner in which the party's marks are accorded protection in the United States. The Nice Agreement provides for 45 international classes of goods and services, and primarily serves to harmonize the classification of goods and services associated with trademark applications filed in member countries.

The Paris Convention provides for national treatment of trademarks and filing priority. Member countries must treat the citizens of other member countries in the same way that they would treat their own citizens. The filing date with the USPTO for member countries' citizens will be the same date that the applicant filed for registration of the mark in his or her own country as long as that occurred within the previous six months.

The Madrid Protocol provides for a central filing system. The main advantage of this system is cost saving. A disadvantage of the system is that the international registration of an applicant's mark is subject to any change in status of the applicant's home application.

2. Copyrights

U.S. copyright law is designed to encourage original and creative expression of ideas and information in a tangible form, such as literary, musical, pictorial, sculptural, motion picture, and other artistic works. To qualify for copyright protection in the United States, a work must possess at least some minimal degree of originality and creativity. As soon as a work is created and the idea or information is fixed in a tangible medium of expression, U.S. federal copyright law automatically protects the work from infringement. That means another person may not copy or publish all or a substantial portion of the work or create a very similar work for a period of time. The length of that time is the shorter of (a) the life of the author plus 70 years, (b) 95 years from the date of publication, or (c) 120 years from the date of creation. To maximize a party's rights, a proper copyright notice should be used on the work. While registration of the copyright with the U.S. Copyright Office is not required for copyright protection, it is normally recommended to enforce the copyright and allow the applicant to qualify for certain types of enhanced damages in the event of an infringement claim. Moreover, registration of a copyright with the U.S. Copyright Office is required before a copyright owner can file suit for copyright infringement.

The United States is a member of the Berne Convention for the Protection of Literary and Artistic Works (the Berne Convention), which provides that the laws of the United States as a member country will protect the rights of the citizens of another member country in the same manner that the laws of the United States would protect the rights of its own citizens. The United States is one of the few member countries that have a formal copyright registration process. In most other countries, it is necessary to establish independent creation and ownership in the work in order to bring a successful copyright infringement action. It is, therefore, critical for a non-U.S. party to maintain proper records of creation of the work in the event it must enforce a copyright in the United States.

3. Patents

There are different types of patents: utility, design, and plant. A utility patent protects the functional feature of a process, method, machine, manufactured item, or composition of matter if the feature is new, useful, and nonobvious. A design patent protects nonfunctional, visual uniqueness. A plant patent gives its owner the right to exclude others from asexually reproducing (i.e., through plant cuttings, grafting, layering, budding, and similar methods) a man-made plant for a certain period of time. Examples of plant patents include apple trees and rose bushes that are propagated by cutting pieces of the stem rather than by germinating seeds.

Patent protection is granted by the USPTO. Since U.S. patent law is designed to encourage investment in new technology and invention and to reward the effort and expense involved in developing new technology, a U.S. patent grants the owner the exclusive right to stop anyone else from making, using, and selling any device that embodies the patented technology for a certain limited period of time.

The first step in the process is to determine if there are any prior patents or patent claims that could block the applicant's technology or product or subject the applicant to liability once it uses or imports products that contain the prior patented technology. It is also critical to determine if the technology is patentable. Assuming it is and there are no prior blocking patents or patent claims, a party should seek the advice of patent counsel to prepare and file an appropriate patent application.

There are various international treaties that can affect a party's patents and an application for patent protection in the United States based on rights in the non-U.S. party's home country, including the Paris Convention, the Patent Cooperation Treaty, and the European Patent Convention.

Under the Paris Convention, a party that originally files a patent application in a member country before the first public disclosure of the invention may then file patent applications in other member countries within a year of the first filing. This allows the applicant to postpone filing foreign patent applications, thereby allowing the applicant to market a new invention without having to file multiple applications.

Under the Patent Cooperation Treaty, an applicant may file a single international patent application designating various member countries. The application then generates a search report. Based on the results of this search, the applicant may then decide where to file national patent applications, which can result in substantial savings to the owner.

Under the European Patent Convention, an applicant may file one patent application with the European Patent Office, which designates the member countries in which patent protection

is sought. Once obtained, a European patent provides the applicant with the same rights as would be granted by separate national patents in the designated countries.

4. Trade Secrets

Protection of U.S. trade secrets is governed by state law. Most states define a trade secret as information that may include a formula, pattern, compilation, program, device, method, technique, or process that derives economic value (actual or potential) from not being generally known to, and not being readily ascertainable by, another person who can obtain economic value from its disclosure or use. The owner must also make reasonable efforts to maintain its secrecy.

Patents and trade secrets cover much of the same items. In practice, however, the two forms of protection are very different. Patent applications require full disclosure of the invention, while trade secret law requires secrecy. Patent protection normally lasts for 20 years from the date of filing of the application, while trade secret protection may last indefinitely.

5. Domain Names

Domain names have proven to be a critical aspect of a company's intellectual property portfolio. The most common cause of problems involves a third party registering a domain name that incorporates a trademark or is confusingly similar to a trademark, which is known as "cybersquatting." To deal with this problem, the United States has adopted the Anticybersquatting Consumer Protection Act (ACPA) that allows for recovery of a domain name that incorporates another party's trademark and has been found to be have been registered and used in bad faith. The ACPA also allows trademark owners to recover significant monetary damages, up to $100,000 per domain name. Trademark owners can also avail themselves of various other administrative dispute procedures such as the popular Universal Dispute Resolution Policy (UDRP) to recover a domain name from a cybersquatter.

The best way to protect a company's domain name may be a proactive approach before a dispute over a domain name ever arises. Typically, this approach starts with a strong trademark portfolio that allows for the greatest protection from cybersquatting. Trademark owners are often given rights to acquire domain names in a defensive manner before the general public can register them. For example, when the .xxx extension (for .xxx domain names) for the adult entertainment industry was introduced last year, trademark owners were allowed access to a special "sunrise" period to register .xxx domain names that incorporated their trademarks before these domain names were made available to others. With limited exceptions, a requirement to participate in the sunrise period was ownership of the trademark.

Finally, trademark owners should consider a defensive domain name registration strategy. This strategy typically involves registering domain names that incorporate their trademarks or ones that are confusingly similar to their trademarks to prevent them from falling into the hands of cybersquatters. These domain names include common typographical errors and other similar verbiage to the company's principal domain name and trademarks. Trademark owners also want to consider registering domains that they would never want to use such as "sucks" or "stinks" domain names (a domain consisting of a company's trademark followed by "sucks" or "stinks") in order to prevent these domain names from being registered to others and used to direct consumers to a complaint or "gripe" website. Preventing domain names from being used

for complaint websites is critically important because, in many instances, the available remedies for recovery of domain names (such as the UDRP and ACPA) cannot be used if the domain name registrant has a legitimate interest in the domain name for free speech, which typically includes complaint websites.

B. Adapting the Franchise Program for the U.S. Market

1. Sourcing

a. Fixtures and Equipment

Local sourcing of fixtures and equipment will be a major step in preparing to franchise in the United States. The look and feel of the franchised business, sometimes referred to as "trade dress," is often an integral part of the franchise system. Therefore, it would behoove a franchisor to explore the possibility of duplicating that in the United States in preparing to launch the franchise program. To the extent it might be necessary to import materials or equipment, the franchisor may end up having to adapt the trade dress or fixtures and equipment to the U.S. market since importing may drive up the cost for franchisees and make the franchise less competitive.

b. Products

(i) Proprietary Products and Recipes

Proprietary products and recipes often present challenges to franchisors embarking upon franchise programs in new countries. Franchisors may be reluctant to release recipes for proprietary products to distant manufacturers, even when nondisclosure agreements are in place. Yet, they may be forced to do so because of restrictions on importing these products. Even if legal impediments to importing products can be avoided, there may be logistical issues or prohibitive costs involved in doing so.

(ii) Nonproprietary Products and Recipes

Less problematic is the issue of sourcing nonproprietary products. Nonetheless, it is essential to make sure that the quality and availability of products is assured. One way to address the procurement challenge is to send a representative to the United States in advance to negotiate arrangements with local suppliers.

2. Unit and Measure Conversion

Most other countries in the world use the metric system of units and measure, unlike the United States. Therefore, it will be necessary to adapt such items as the operations manual, architectural plans and specifications, and recipes.

3. Translation and Interpretation Issues

a. Written Materials

Non-U.S. franchisors entering the U.S. market must also consider whether or not to translate written materials into American English. This applies to franchisors from English-speaking

countries as well as to non-English-speaking countries. Because English is used in many business settings, this is likely an easier step than it would be to enter another country's market. Therefore, it is more likely that the franchisor will have already translated written materials such as the operations manual into English.

b. Training

Similarly, it is important to prepare a training program for U.S. franchisees in advance of entering the U.S. market. One method is to limit franchising to nationals of the franchisor's market who can be trained in the franchisor's host country. Another is to develop training in English in the franchisor's country for all franchisees from countries other than that of the franchisor. Once a franchisee has sufficient personnel that has been successfully trained, it may be feasible to conduct "Train the Trainer" programs so that additional initial training can be conducted by experienced franchisees themselves.

c. Quality Assurance issues

Quality assurance inspections can be challenging in the international context. Unless the franchisor has a well-staffed presence in the United States, it may conduct operational audits on a less frequent basis than is necessary to maintain brand standards. Retaining local quality-assurance inspection services offered by third-party suppliers and mystery shopping firms are options to consider.

4. Changes to Meet Local Market Preferences

Any franchisor entering a new international market should consider whether or not to vary its system to address local preferences. For example, some restaurant concepts may need to modify their menu offerings to adjust to American taste. Portion sizes may also be affected, and that can in turn require a change to the pricing structure.

In some circumstances, however, the success of the system in the United States is predicated on being different or on appealing to a sector of the U.S. population that has emigrated from the franchisor's home country or has ethnic ties to it. While this may limit the success of the concept in the United States, it can also provide a platform from which to launch development that can be adapted to U.S. taste later, if necessary. In the meantime, there is a solid customer base with awareness of the brand.

III. Structuring the U.S. System

A. Choice of Entity

The choice of an entity to conduct franchise operations in the United States is driven by a number of considerations, including tax and accounting issues as well as issues related to the franchisor's disclosure obligations under U.S. franchise laws. In making this decision, the non-U.S. company should consult with tax counsel in both the United States as well as in its country of domicile. See Chapter 3 for a detailed discussion on the potential tax ramifications of entering the U.S. market.

1. U.S. Domestic Entity

Generally, non-U.S. franchisors will form a U.S. entity to conduct operations in the United States. While a company's specific circumstances may vary, it would not usually be advisable to use a "pass through" entity. These are entities, such as limited liability companies, through which taxable income is passed to owners who are taxed on that income. In contrast, non-pass-through entities, such as corporations, are taxed at the entity level, and any distributions to their owners are taxed separately at the owner level. Although it would seem advantageous to avoid the double taxation, using a pass-through entity may cause non-U.S. owners to have to file U.S. tax returns and pay taxes based on those returns.

As a general rule, the state of incorporation has minimal impact on the state and local income taxes paid by a corporation because state and local income taxes are generally imposed based on the corporation's connections with, and level of activity within, any given state. Therefore, the decision to incorporate in a particular state should generally turn on other factors such as the extent to which the state's laws and courts tend to be more protective of businesses. Delaware is often considered as a jurisdiction in which to incorporate.

Incorporating in Delaware offers a number of advantages, among them are the following:

a. Incorporating in Delaware enables a corporation to avoid certain "oddities" under other states' laws such as shareholders' rights in California to cumulative shareholder voting;
b. Delaware has a more well-developed body of case law regarding corporate governance and other corporate matters than most other states, and Delaware law is generally more protective of corporations. Also, Delaware courts are generally considered more "business friendly";
c. The capital markets are more familiar with Delaware corporations;
d. The restrictions on a Delaware corporation's ability to make distributions (and the liability therefor) are more liberal than those in other states;
e. Under Delaware law, a creditor's ability to access distributions made by the corporation is not as extensive as under other states' laws.

The drawbacks to incorporating in Delaware are the additional filing fees that would be incurred as a result of the incorporation if the franchisor's operations are not based in Delaware, and the fact that the franchisor would have to designate an agent for service of process in Delaware. If the franchisor has an office in another state and is, therefore, "doing business" there, there will be filing obligations in that state and obligations to pay fees, regardless of whether the franchisor is incorporated in the state. Although Delaware imposes a "franchise tax" on Delaware corporations, it is generally based on the number of shares of stock authorized by the company and thus can be managed by keeping the level of authorized shares low.

2. Non-U.S. Entity

In addition to tax issues, there are also considerations involving disclosure requirements under U.S. franchise laws. If the franchise activity is being conducted by a non-U.S. entity, the financial statements of that entity are likely to be prepared in accordance with standards other than U.S. generally accepted accounting standards. See Section C.1 below for an analysis of this issue.

B. Distribution Methods

There are many variations to the possible structure of a franchise program in the United States. Following are descriptions of some of the more common forms.

1. Direct Franchising

Direct franchising, sometimes referred to as unit franchising, means a franchise in which the franchisor grants the franchisee to operate a single business under the franchisor's name and system. The parties sign an agreement that is usually referred to as a franchise agreement or a license agreement. The business is generally at a single location in a geographic territory, although a unit franchise may not have a set location at all if the business is Internet-based, a mobile franchise, a personal service franchise, or a home-based business.

2. Area Development

Area development programs involve the grant of the right to operate a number of unit franchises to a single developer. These arrangements typically involve the grant of a territory with exclusive rights to develop the unit businesses so long as the developer complies with the terms of its agreements with the franchisor, including a development schedule. The developer enters into separate franchise agreements for each new location, although occasionally a franchisor will grant unit rights in the area development agreement itself. The developer does not have the right to grant any of these rights to develop unit franchises to others.

These agreements usually provide that the franchisor reserves the right to conduct certain activities in the developer's territory such as servicing national or regional accounts and operating at nontraditional locations such as airports, sports arenas, amusement parks, convention centers, toll-road plazas, or museums. Other types of rights that a franchisor may want to reserve include the ability to develop businesses under different trademarks even if they involve the same general type of business.

Since the development schedule is crucial to the development of the market, it is important to make sure that adequate development will occur. The size of the territory and the capitalization of the developer are key, since granting a territory that is too large can be a problem if that results in slower development of the brand. Developers often wish to tie up larger geographic territories than they have the wherewithal to develop, so it may be advisable to structure smaller territories with rights of first refusal or options to develop adjacent geographic areas rather than grant the rights to a territory too large to develop or a development schedule that the developer will have difficulty meeting.

Default and termination provisions are also important to consider. For example, if the developer fails to meet the development schedule and loses its development rights to the territory, what will happen to the individual businesses it has opened? Will those agreements remain in effect, and, if so, will there be any geographic protection accorded the franchisee? Conversely, if a franchisee defaults under a franchise agreement and that agreement is terminated, what effect will it have on the developer's other franchise agreements or development rights?

3. Master Franchising

In a master franchise program (sometimes referred to as a sub-franchise program), the franchisor grants the right to a master franchisee to develop a territory and the master franchisee also has the right to grant unit franchises to sub-franchisees. The master franchisee may also have the right to develop units itself. Some master franchise programs require that the master franchisee must develop a certain number of unit franchises before being able to sub-franchise rights to third parties.

This type of program permits a more rapid development of the market, but it also results in less control over that development by the franchisor. In addition, this type of program presents additional regulatory issues. The offer and sale from the franchisor to the master franchisee is subject to disclosure and, where required, registration requirements. The offer and sale from the master franchisee to sub-franchisees must also comply with the requirements of U.S. franchise laws. The disclosure document prepared for the sub-franchise must include information about both the franchisor and the master franchisee, and both are liable for any omissions or misstatements. Therefore, the agreement between the franchisor and master franchisee must address who will prepare that disclosure document, how the information about the parties will be exchanged, who bears the cost of compliance, and how the parties will protect each other if a violation occurs.

4. Area Representatives

Area representatives (sometimes referred to as development agents) solicit candidates for a franchisor that meet its qualifications for prospective franchisees. They also provide some or all of the services that the franchisor is required to provide to the franchisee under the franchise agreement. These may include training, quality-assurance control, advertising support, and product and service supplier information.

Unlike master franchisees, area representatives have no contractual relationship with the franchisee. While area representatives most frequently represent the franchisor in its relationship with unit franchisees, they may also represent a non-U.S. franchisor in its relationship with an area developer or a master franchisee.

The Federal Trade Commission (FTC) has indicated that its Franchise Rule (see Section IV.A below) does not apply to area representatives unless they have a contractual relationship with the franchisee. Certain states, however, have indicated that they will require that disclosure about these area representatives be included in the franchise disclosure document for a franchise program by the franchisor.

C. Form of Agreement

As noted above, differences in the U.S. franchise regulatory system may make it advisable for a franchisor to alter its system and franchise agreement for use in the United States. Even if the franchise system was developed in another common law English-speaking jurisdiction, drafting conventions are different and it may be necessary to "Americanize" the agreement.

IV. Disclosure and Registration

A. Federal Trade Commission Franchise Rule

On July 1, 2007, an amended version of the Federal Trade Commission's Rule on Disclosure Requirements and Prohibitions Concerning Franchising (the FTC Rule) came into effect. First adopted in 1978, the FTC Rule requires that presale disclosure be provided to prospective franchisees in the United States and its territories.

1. Definition of Franchise

The FTC Rule defines a franchise as a continuing commercial relationship in which the franchisor grants the franchisee the right to operate a business that is identified with the franchisor's trademark or commercial symbol or to offer goods or services that are associated with that trademark or symbol. The franchisor must also have the right to exert a significant degree of control over the franchisee's method of operation or to provide significant assistance in that operation. Finally, the franchisee must be required to make a payment to the franchisor or affiliate. All three elements of the franchise definition must be present in the relationship. If one is missing, the relationship is not a franchise. It does not matter what name the relationship is given. If it falls within the definition of a franchise, it is a franchise and, therefore, must comply with the disclosure requirements of the FTC Rule.

2. Disclosure Requirements

A franchisor must provide a prospective franchisee with a copy of its franchise disclosure document at least 14 calendar days before the franchisor receives any consideration from the franchisee or the parties sign a binding agreement. The franchise disclosure document must contain 23 categories of information. The FTC Rule does not require that a franchisor file this document or obtain a registration.

There are 23 items in the FTC Rule's disclosure format, requiring information on the following categories:

1. The Franchisor and Related Parties. This item requires disclosure about the franchisor, its parents, its affiliates that provide products or services to the franchisees or that offer franchises in any line of business, and predecessors. A franchisor must also describe the business being franchised, the general market for the business, information about competitors, and the prior business experience of the franchisor, any predecessor, and affiliates.
2. Business Experiences of Franchisor's Management. This item includes five-year employment histories for the principal officers of the franchisor, its directors, general partners, trustees, and any other individuals with management responsibility for the sale or operation of the franchises.
3. Litigation. Information about certain types of pending and concluded litigation must be included here for the franchisor, any predecessor, certain parents or affiliates of the franchisor, and the individuals listed in the second item.

4. Bankruptcy. Bankruptcy history during the past 10 years both in the United States and in other countries must be disclosed for the franchisor, its parents, affiliates, any predecessor, and the individuals listed in item 2.
5. Initial Fees. Disclosure is required for all fees that a franchisee must pay for goods and services received from the franchisor or its affiliate before the franchisee's business opens.
6. Other Fees. The chart in this item must include other fees that the franchisee must pay to the franchisor or its affiliate. They include fees that the franchisor collects for payment to third parties.
7. Estimated Initial Investment. Once again, in the format of a chart, the franchisor must include an estimate, broken down by category, of the various amounts a franchisee must spend to begin operating the business. This includes a working capital component for amounts estimated for the initial phase of the business, which must be at least three months.
8. Restrictions on Sources of Products and Services. This disclosure includes any restrictions on a franchisee's ability to purchase or lease goods, services, supplies, fixtures, equipment, inventory, computer hardware or software, real estate, insurance, and similar items. It may be a designation or approval of a supplier or provision of specifications for the item. The franchisor must also disclose, on an annual basis, the amount of revenue that it and its affiliates receive on account of purchases by the franchisees.
9. Franchisee's Obligations. Specified obligations of the franchisee in various categories must be included in a chart that cross-references provisions in the franchise agreement and the franchise disclosure document.
10. Franchisor Financing. If the franchisor offers financing to franchisees, either directly or through an arrangement with a lender, disclosure must be included for the terms of the financing and sample documents must be attached to the franchise disclosure document.
11. Franchisor's Obligations. This disclosure is divided between preopening obligations and those required during the course of the franchise relationship. Disclosure is also required in certain categories such as advertising programs, computer systems, training programs, and the operations manual.
12. Territory. Information about the territorial rights granted to a franchisee, and any restrictions on them, must be included in this item. Any options or rights of first refusal must also be disclosed. Disclosure concerning other channels of distribution and the parties' rights to use them is also required.
13. Trademarks. Principal trademark registration information is required, along with any material determinations of the USPTO, any litigation, and information about any agreements that affect the franchisor's right to grant franchisee a license to use the marks. The parties' respective rights and obligations if a third party accuses the franchisee of infringement or if the franchisee learns of a third party that is using the trademarks must also be disclosed.
14. Patents and Copyrights. Material information about determinations by the USPTO, the U.S. Copyright Office, and courts concerning the franchisor's patents and copyrights relevant to the business must be disclosed. Disclosure is also required regarding

what will occur if a third party asserts rights to the patent or copyright or if the franchisee learns of an infringing use.

15. Franchisee's Obligation to Participate in the Business. Any obligation to participate personally in the franchised business must be disclosed. If a manager is permitted, any restrictions on the manager, such as ownership interest in the business, must be disclosed.
16. Restrictions on the Franchisee's Sales. A franchisor must disclose any restrictions on the goods or services the franchisee may offer, and any obligations to offer goods or services.
17. Renewal, Termination, Transfer, and Dispute Resolution. A chart is required that summarizes the provisions in the franchise agreement concerning these topics.
18. Public Figures. If a public figure endorses the franchise to prospective franchisees, certain disclosure is required in this item.
19. Financial Performance Representations. Financial performance information disclosure is not required. This is defined as a representation that states or implies a specific level or range of actual or potential sales, income, gross profits, or net profits. A franchisor may include a franchise performance representation based on the historic operations of its system or a subset of the system, or may include a forecast or projection of possible performance, if it has a reasonable basis for doing so. If no financial performance representation is made in this item, the franchisor and its representatives are prohibited from otherwise providing this information to prospective franchisees.
20. Information on Outlets. Five different charts that provide information about franchisees' outlets and those of the franchisor must be included in this item. In addition, lists of current franchisees and those who have left the franchise system during the preceding fiscal year, and their contact information, must be included.
21. Financial Statements. Audited financial statements for the franchisor's preceding three fiscal years must be included. These financial statements must be prepared by an independent certified public accountant using U.S. generally accepted auditing standards. Franchisors that are new to franchising may phase in the use of audited financial statements.
22. Franchise Contracts. This is a list of the contracts that involve the franchise relationship.
23. Receipt. The mandated form of receipt must be signed by the franchisee and returned to the franchisor. It contains information about the franchise sellers involved in the transaction and may need to be updated if additional franchise sellers become involved in the sales process.

3. Exemptions

There are a number of exemptions to coverage by the FTC Rule. If the total required payment or commitment to make payments during the first six months of the operation of the business total less than $500, the relationship is exempt. Required payments do not include payments at a bona fide wholesale price for inventory for the business if the franchisee is not required to purchase more than a reasonable businessperson would. Thus, most dealerships are exempt from the FTC Rule's disclosure requirements.

A "fractional franchise" is also exempt under the FTC Rule. This is a franchise in which the franchisee or its officers or directors (or those of an affiliate) have more than two years of experience in the same type of business, where the parties reasonably anticipate that the sales from the relationship will not exceed 20 percent of the franchisee's total dollar volume during the first year of operations.

Another exemption applies if the franchisee is an entity that has been in business for at least five years and has a net worth of at least $5 million.

If a franchise involves an initial investment of at least $1 million, excluding any amounts financed by the franchisor and the cost of unimproved land, it will also be exempt from the disclosure requirements of the FTC Rule.

The insider's exemption applies if one or more of the purchasers of a minimum 50 percent interest in the franchise has been an officer, director, general partner, or person with management responsibility for the offer and sale of the franchisor's franchises or the administration of the franchised network for at least two years. The qualifying person must have been in that position within 60 days of purchasing the franchise. An owner of at least a 25 percent interest in the franchisor for two years will also be eligible for this exemption.

Finally, there are exemptions for oral agreements, leased departments where an independent retailer sells its own goods and services in space leased from a larger retailer in the larger retailer's space, and petroleum marketers and resellers.

B. State Franchise Laws

1. Laws Regulating Offer and Sale of Franchises

The following states regulate the offer and sale of franchises: California, Hawaii, Illinois, Indiana, Maryland, Michigan, Minnesota, New York, North Dakota, Oregon, Rhode Island, South Dakota, Virginia, Washington, and Wisconsin.

a. Definition of Franchise

State law definitions of what constitutes a franchise vary somewhat. California's Franchise Investment Law, which was the first law adopted in the United States in the early 1970s, defines a franchise as an agreement by which a franchisee is granted the right to engage in a business under a marketing plan prescribed in substantial part by the franchisor. The business must be substantially associated with the franchisor's mark or commercial symbol, and the franchisee must be required to pay a franchise fee. Some states, such as Hawaii and Minnesota, substitute the requirement that the parties have a community of interest for the marketing-plan element. South Dakota has adopted the FTC Rule's definition. New York's definition is unique in that there are only two elements to a franchise: either a marketing plan prescribed in substantial part and payment of a franchise fee or substantial association with the franchisor's trademark and payment of a franchise fee.

b. Jurisdiction

There are a number of different ways to trigger jurisdiction of state laws, and states vary on which ones apply. The factors include the state of the franchisee's domicile, the place where the business will be operated, and whether an offer or sale is made in the state. All of the states except New York limit the extraterritorial application of their laws. The New York Franchises

Act, on the other hand, requires registration for offers and offers to sell franchises in the state. An offer or sale is made in New York when an offer to sell is made in the state, an offer to buy is accepted in the state, or if the franchisee is domiciled in the states and the franchised business will be operated in the state. An offer to sell is made in the state when the offer originates from the state or is directed by the offeror to the prospect in the state and received at the place to which it was directed. Thus, someone could just be passing through New York during the sales process and trigger New York's jurisdiction.

All of the states that regulate the offer and sale of franchises provide that an offer to sell a franchise is not made in the state if an advertisement appears in a publication of general, regular, and paid circulation outside the state during the past 12 months or on a radio or television program originating outside the state and is received in the state.

c. Disclosure Requirements

All of the states that regulate the offer and sale of franchises require presale disclosure. The waiting time after disclosure before a franchisee can pay consideration or sign an agreement varies. Shorter waiting times are preempted by the FTC Rule's 14-day requirement, but longer waiting times will not be affected by federal law. As of this writing, two states (Michigan and Washington) require that disclosure be provided 10 business days before the payment of consideration or execution of an agreement, and two more (New York and Rhode Island) add the requirement that disclosure be made at the first personal meeting of the parties to discuss the possible purchase of a franchise if that is earlier than the 10 business-day period.

The states with these franchise laws accept franchise disclosure documents prepared in the format required by the FTC Rule with some additional information, which is usually addressed in state-specific addenda by franchisors. Franchisors generally prefer using a multistate document. In its 2008 Franchise Registration and Disclosure Guidelines, the North American Securities Administrators Association (NASAA) also requires a state cover page that immediately follows the FTC Rule–mandated cover page.

d. Registration Requirements

A franchisor must file an application to offer and sell franchises in 14 of the 15 states that regulate the offer and sale of franchises. These applications range from a notice filing to a full examination of the proposed franchise disclosure document and an analysis of whether or not it meets the requirements of the required disclosure format. Many states are required to respond within statutory mandated periods, and may require a waiver of those provisions.

e. Exemptions

The exemptions from state law vary from the FTC Rule exemptions as well as from state to state. Some exemptions are from both registration and disclosure and others are from registration alone. Even in cases in which two jurisdictions have similar exemptions such as the fractional franchise exemptions, there can be differences. For example, California's fractional franchise exemption requires that the new franchised business be operated from the same premises as the franchisee's existing business while other fractional franchise exemptions do not.

Another type of exemption that many states have (but is not available under the FTC Rule) is a large franchisor exemption. In most instances, a franchisor must have a minimum net worth of $5 million or more, depending on the jurisdiction, and a number of years of

experience (generally five years) administering a franchise system with at least 25 franchisees or operating the business itself. An example of a variation of this type of exemption was adopted by New York that provides that a franchisor with a net worth of at least $5 million may apply for an exemption, and a self-executing exemption for franchisors with a net worth of at least $15 million. Under both of these exemptions there is still a limited disclosure obligation.

Other types of exemptions that have been adopted by fewer states are exemptions for cooperative associations, sophisticated or experienced purchasers, isolated or limited number of sales, out-of-state sales, sales by an executor or trust, sales to banks or institutional investors, and sales to existing franchisees.

None of the states require registration and disclosure of transfers by existing franchisees if the franchisor does not become involved in the transaction. The ability of the franchisor to approve or disapprove the transferee is not sufficient involvement to trigger registration and disclosure obligations. Similarly, the renewal of an existing franchise is not subject to these requirements. If there is a material change, such as the requirement that the franchisee sign the franchisor's then current form of franchise agreement, the exemption does not apply.

State regulators have the authority to grant discretionary exemptions if they make a determination that the proposed transaction does not require the protection of the franchise law. Some states, however, have adopted a policy to refuse to grant such exemptions despite their authority to do so.

States that provide for exemption from registration or disclosure requirements typically retain jurisdiction over issues such as fraud and misrepresentations that a franchisor or its representatives may make in connection with the offer and sale of the franchise.

f. Advertising and Franchise Seller Filings; Broker Registration

Seven of the registration states require franchisors to file advertising materials directed at the sale of franchises a certain amount of time (ranging from three to seven days) before publication or use. Many states also have restrictions on the contents of advertising, including prohibitions on representing that a franchise is guaranteed to be successful, that the franchisee will earn money or similar representations.

2. Relationship Laws

The following U.S. states and territories regulate the relationship between franchisors and franchisees: Alaska, Arkansas, California, Connecticut, Delaware, Hawaii, Idaho, Illinois, Indiana, Iowa, Louisiana, Maryland, Michigan, Minnesota, Mississippi, Missouri, Nebraska, New Jersey, North Dakota, Rhode Island, South Dakota, Virginia, Washington, Wisconsin, Puerto Rico, and the Virgin Islands. Typically, these laws restrict a franchisor's ability to terminate a franchise relationship, often mandating good cause and notice requirements and providing for the ability of the franchisee to cure a default after receiving notice. They also restrict the circumstances under which a franchisor can decide not to renew the franchise.

Other aspects of the franchise relationship that may be covered by these laws include the right of a franchisee to associate with other franchisees, the location and governing law for dispute resolution, and competition by the franchisor. Several states also prohibit discriminatory actions by the franchisor with respect to franchisees.

The types of contractual relationships covered by these laws also vary and may include other forms of distribution arrangements as well as franchises.

C. Issues and Considerations Affecting Inbound International Franchisors

1. Financial Statements

The FTC Rule requires that a franchisor include audited financial statements in its disclosure to prospective franchisees. The financial statements must be prepared according to U.S. generally accepted accounting principles (GAAP) as revised by any future U.S. mandated accounting principles or as permitted by the U.S. Securities and Exchange Commission (SEC). The financial statements must be audited by an independent certified public accountant (CPA) using U.S. generally accepted auditing standards (GAAS).

Non-U.S. franchisors that do not form a U.S. affiliate to conduct the franchise program may face the issue of whether or not their CPA and audited financial statements meet these standards.

The FTC Rule does not restrict the definition of a CPA to a U.S. CPA. However, an accounting firm auditing financial statements to comply with the FTC Rule's requirements must, at a minimum, register with the Public Company Accounting Oversight Board (PCAOB), established by the Sarbanes-Oxley Act of 2002. Non-U.S. auditors must also meet independence requirements, like their U.S. counterparts.

In summary, all non-U.S. accounting firms wishing to prepare audited financials under the FTC Rule must (1) be registered with PCAOB; and (2) recently have audited one or more financial statements that have been filed and accepted by the SEC.

Non-U.S. accountants must meet any additional qualifications that the SEC may impose including a review of the accountant's quality controls (which is typically conducted by a consultant that the accounting firm retains), personnel qualifications, knowledge of professional standards, and recent audit performance. The foreign accountant must have all filings with the SEC that contain its audit report reviewed by a knowledgeable U.S. or foreign accountant. The filings must have been prepared using U.S. GAAP and the audits must have been prepared using U.S. GAAS.

2. Impound Conditions

Most of the laws adopted by states that regulate the offer and sale of franchises accord examiners the power to address situations in which they are concerned with the ability of a franchisor to provide services promised to franchisees to get them up and running. These include the ability to impose a requirement that the franchisor escrow initial fees paid by the franchisee until the franchisee opens for business. Depending on the state, alternatives are available to franchisor applicants, including (1) posting a surety bond, (2) obtaining the guaranty of a parent or affiliate corporation, (3) deferral of payment of initial fees by the franchisee until all preopening services have been provided by the franchisor, (4) an additional capital infusion, and (5) a loan by a principal of the franchisor with an agreement not to require repayment for a certain amount of time. Of course, an examiner can also require a franchisor to add a risk factor to address the specific circumstance of the financial condition that has caused concern.

3. Financial Performance Representations

A franchisor in the United States is not required by the FTC Rule to make a financial performance representation. Many franchisors, including non-U.S. franchisors entering the U.S. market, do wish to make such representations in item 19 of their franchise disclosure documents so that they and their representatives can discuss the substance of these representations with prospective franchisees.

An issue can arise for a non-U.S. franchisor, however, because when it enters the U.S. market it does not have franchisees in the United States and, therefore, cannot base its financial performance representation upon U.S. franchisees' historical results. If the franchisor is a newly formed U.S. entity, it will not have any financial results based on its own company operations.

The FTC Rule requires that a franchisor have a reasonable basis and written substantiation for any financial representation it makes. The FTC staff has addressed the issue of whether or not the financial experience of the franchisor's affiliate can form the basis of a financial performance representation. Under limited circumstances, it is permissible if the franchisor does not have any operating history and the affiliate's operations are substantially similar to those of the franchised business being offered. Whether the affiliate's franchisees outside of the United States could provide the data for a financial performance representation is an open question. By analogy to the FTC staff's opinion on affiliate operations, it may be permissible, depending on whether the operations in the franchisor's native country are substantially similar to those planned in the United States. The U.S. operations may vary due to local taste, differences in suppliers, and language and, therefore, there may not be a reasonable basis for using these numbers to present a financial performance representation.

4. Determination of Initial Investment by Franchisee

A crucial element of the disclosure that a franchisor must provide to a prospective franchisee is an estimate of the initial investment a franchisee will have to make to start the business. This estimate must be broken down into categories. Strangely, the prospective franchisee will often have more information than the franchisor on what a reasonable estimate of what many of these expenses will be. If a franchisor first operates the franchised business itself in the United States, it will be in a much better position to estimate the initial investment necessary.

5. Transfer Pricing Issues

Section 482 of the Internal Revenue Code provides that the Internal Revenue Service (IRS) may reallocate gross income, deductions, credits, or allowances between or among organizations, trades, or businesses that are under common control if such reallocation is necessary in order to prevent evasion of taxes or to reflect clearly the income of any such organizations, trades, or businesses. Section 482 allows the IRS to reallocate items for tax purposes if it finds that commonly controlled organizations are entering into pricing or allocation arrangements that are not consistent with "arms-length" arrangements and are designed to minimize taxes to the organizations on a collective basis. Franchisors must make sure that prices on any licensing or other arrangements between affiliates are set on an arms-length basis in order to avoid the

application of Section 482. A non-U.S. franchisor should seek the counsel of a U.S. tax professional on this issue.

6. Sub-Franchise Disclosure Issues

In the United States, disclosure to a prospective sub-franchisee must include information about both the franchisor and the master franchisee. Therefore, master franchise agreements typically include provisions that address which party is responsible for preparing the franchise disclosure document for sub-franchisees. The agreement should also provide that the franchisor and master franchisee must each provide accurate information for inclusion in the franchise disclosure document, and that they indemnify one another for any claims based on false or misleading information or material omissions.

V. Other Regulatory Issues

A. Antiterrorism Laws

Once they begin doing business in the United States, non-U.S. franchisors must investigate and comply with certain antiterrorism and similar laws, especially if they form a U.S. entity to conduct business in the United States. The U.S. Treasury implements various laws and measures for the purpose of enhancing national security through economic sanctions, addressing financial networks of terrorist organizations and safeguarding domestic financial institutions.

The Treasury Department's Office of Foreign Assets Control (OFAC) maintains a list of individuals, entities, and organizations with whom U.S. citizens and companies are prohibited from engaging in business. These are known as specially designated nationals, or SDNs. This list, which is periodically updated, can be accessed at http://www.treasury.gov/ofac/downloads/t11sdn.pdf.

The OFAC also maintains information about sanctions imposed against certain countries and administers these sanction programs. Information about these programs is available at http://www.treasury.gov/resource-center/sanctions/Programs/Pages/terror.aspx. It is possible to set up an alert through the website to be notified in the event of any changes to the sanction programs.

In addition to Treasury Department prohibitions, the U.S. State and Commerce Departments also maintain separate lists of entities and individuals with whom U.S. "persons" (including U.S. companies) may not do business. These prohibited-party lists are constantly updated, so many U.S. businesses with large customer bases purchase screening software or outsource this function to ensure that they do not do business with proscribed parties. Such screening is often included as part of a company's regular customer financial vetting process.

Under Section 311 of the USA PATRIOT Act, the Treasury Department also has the ability to identify institutions involved in money laundering. If the department identifies a transaction or financial institution as a "primary money-laundering concern," it can require U.S. domestic financial institutions to take certain measures under the act.

Finally, there are antiboycott laws that limit U.S. companies' ability to agree to participate in a boycott that is not sanctioned by the U.S. government.

B. Import Restrictions

Non-U.S. franchisors should understand that any goods or materials exported to the United States will be subject to formal U.S. Customs entry procedures, including duty assessment, if applicable. A key decision for foreign franchisors is the choice of person or entity to act as "U.S. importer of record" in connection with imports into the United States. The importer of record is the party responsible to U.S. Customs for the payment of duties and compliance with all import restrictions and formalities. The foreign franchisor can do one of the following: (1) establish a U.S. subsidiary for this purpose, (2) rely on an unrelated third party (such as its U.S. developer), or (3) act as a foreign importer of record itself, although this last alternative is not generally recommended.

In addition to U.S. Customs and Border Protection entry procedures, any items sent to the United States may be subject to product-specific regulation by a multitude of other federal and state agencies. For example, federal labeling regulations often differ depending upon the product involved, and certain U.S. states (California, particularly) may have additional labeling requirements beyond federal standards. It is, therefore, extremely important that a non-U.S. franchisor exporting to the United States be aware of all federal and applicable state regulations that may pertain to the items being shipped.

Non-U.S. franchisors also need to verify that there are no country-specific U.S. import restrictions affecting their intended exports. The United States enforces a number of antidumping and countervailing duty orders that often result in extremely high duties on products manufactured in particular countries. Franchisors sourcing product for shipment to the United States from outside of the country, particularly from sources in Asia, should verify that their products are not within the scope of existing trade case orders in order to avoid potential large-duty assessments.

C. Immigration Issues

A non-U.S. franchisor will often send personnel to the United States for purposes of planning, training, and inspection of franchised locations. Admission of foreign persons into the United States is governed exclusively by the U.S. immigration laws. Individual states have no authority to grant work visas.

Generally, a non-U.S. individual can be admitted into the United States under one of two broad categories—immigrant or nonimmigrant. Immigrant status is an appropriate goal for persons seeking to become permanent residents of the United States. Individuals with permanent residence have the right to live in the United States indefinitely and to pursue virtually any investment or business objective. Obtaining permanent residency status as an immigrant is commonly referred to as obtaining a "green card."

The number of foreign persons who can obtain immigrant status in any year is generally limited, and there are preferences that favor relatives of U.S. citizens or individuals who possess unique skills that are difficult to find among U.S. workers.

The majority of non-U.S. citizens who enter the United States do so through nonimmigrant visas. A nonimmigrant visa allows a foreign person to reside temporarily in the United States for a given period of time and, depending upon the particular visa classification, to engage in specific permitted activities.

An analysis of visa types and the criteria for eligibility is attached as Appendix 1.

VI. Conclusion

Careful planning and analysis is necessary before a non-U.S. franchisor launches its franchise program in the United States. An initial, crucial step is the protection of the franchisor's intellectual property. Structuring the franchisor's organization, including determining whether or not to establish a U.S.-based affiliate to conduct the operations, involves tax concerns in both the United States and the franchisor's domicile. It is also important to determine the type of structure that the franchise program should take, the degree of control that the franchisor will have over it, and the legal ramifications that the structure entails. While many non-U.S. franchisors have avoided the U.S. market in the past because of the regulation of franchises, many are now more familiar with the regulatory framework in light of the increase in franchise laws around the world.

Note

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Appendix 1

Visa Types and Requirements

1. Immigrant Visa—Employment-Based Investor Immigrant Classification

The 1990 amendments to the Immigration Act created another employment-based investor immigrant classification, the EB-5 category. Individuals who invest $1 million in capital in a new commercial enterprise or troubled business and who employ 10 or more persons in the United States can receive permanent residence status in the United States. The amount of investment required is adjusted downward if the investment is made in certain targeted high-unemployment areas. Application for this immigrant visa classification is made on Form I-526, which is accompanied by substantial supporting documentation. Investors in this category can also invest in approved Regional Centers. Regional Centers pool the investor's money and invest in projects that are also aimed at creating new jobs. There are currently well over 200 Regional Centers in the United States. The cumbersome labor certification process does not apply to this category (i.e., the petitioning company does not have to demonstrate that qualified U.S. workers are unavailable to perform the job in question or that the foreign person's employment will not adversely affect the wages or working conditions of similarly employed U.S. workers). These immigrant visa petitions are closely scrutinized.

2. Nonimmigrant Visa

a. Visa Type: B-1 (Business Visitor) Visa

The B-1 (Business Visitor) visa is designed for foreign persons whose presence in the United States will be limited to a few months. Activities associated with international trade or commerce are among the activities permissible under a B-1 visa. For example, a recipient of a B-1 visa can enter the United States to sign contracts and open bank accounts. However, active management of an investment or business while in the United States is not authorized under a B-1 visa. Furthermore, employment in the United States is not permitted. The normal rules for B-1 activities have been revised for Mexican and Canadian businesspersons under terms of the North American Free Trade Agreement (NAFTA). Under NAFTA, Mexican and Canadian businesspersons have more-liberal terms of entry with regard to some B-1 activities than do nationals of other countries.

Requirements for a B-1 Visa

Among the requirements for the issuance and maintenance of a B-1 visa are the following:

- The foreign person must intend to depart the United States at the expiration of the term of the visa.

- The foreign person must possess sufficient financial resources to travel and depart from the United States.
- The foreign person must maintain a foreign residence throughout the person's stay in the United States.

An application for a B-1 visa is made at a U.S. consulate abroad. An applicant is not required to file any paperwork with the U.S. Citizenship and Immigration Services (USCIS), the agency that administers the immigration laws.

b. Visa Type: U.S. Visa Waiver Program

The U.S. Visa Waiver Program is an expedited method for nationals of certain countries to visit the United States for up to 90 days to engage in activities permitted under a B-1 visa. Instead of applying for a B-1 visa at a U.S. consulate and meeting the B-1 visa requirements, foreign nationals of countries that participate in the Visa Waiver Program must satisfy the following criteria: obtain electronic preapproval through the Electronic System for Travel Authorization no later than 72 hours before departing for the United States; acquire a non-transferable round-trip ticket from an approved airline; travel on a passport issued by one of the participating countries; and, before arriving in the United States, sign a Form I-94W, in which the person acknowledges understanding the terms of the Visa Waiver Program, including the absence of any right to a hearing pending deportation if the person stays in the United States over 90 days. Individuals in the United States on the Visa Waiver Program may not extend their stay or change to another nonimmigrant status while in the United States. Visa Waiver Program participants cannot apply for adjustment of status unless they are immediate relatives of U.S. citizens. Persons interested in participating in the Visa Waiver Program should check with USCIS website, uscis.gov, or their immigration attorneys to determine if their country participates in this program.

c. Visa Type: E (Treaty Trader/Investor) Visa

The E (treaty trader or treaty investor) visa category is intended for foreign persons seeking entry into the United States for extended periods of time. An initial stay of one year is granted to holders of E visas, which can be extended almost indefinitely. Two types of E visas can be issued. A holder of an E-1 (Treaty Trader) visa is permitted to oversee or work in an enterprise engaged in substantial trade with the United States. A holder of an E-2 (Treaty Investor) visa is authorized to engage in activities relating to a substantial investment in the United States. Separate requirements govern the issuance of E-1 and E-2 visas.

Requirements for an E-1 Visa

The following requirements must be satisfied to obtain an E-1 visa:

- A treaty containing treaty-trader provisions must exist between the United States and the country in which the foreign person has citizenship. A current list of countries with which the United States has outstanding treaties with such provisions can be found at http://travel.state.gov.

- At least 50 percent of the sponsoring U.S. employer must be owned by nationals of the treaty country.
- The E-1 applicant must have the same nationality as the treaty enterprise.
- The foreign person or the person's employers must be engaged in ongoing "trade," which, for this purpose, is the exchange, purchase, or sale of goods, services, or technology.
- The trade engaged in by the foreign person or the person's employer must be "substantial." At present, no minimum dollar amount is used in determining whether a specific amount of trade is substantial. Instead, the evaluation is made on the basis of such factors as the quantity of transactions and the volume, nature, and duration of the trade.

Requirements for an E-2 Visa

The following requirements must be satisfied to obtain an E-2 visa:

- A treaty containing treaty-investor provisions must exist between the United States and the country in which the foreign person has citizenship. A current list of countries with which the United States has treaties with such provisions can be found at http://travel.state.gov.
- At least 50 percent of the sponsoring U.S. employer must be owned by nationals of the treaty country.
- The E-2 applicant must have the same nationality as the treaty enterprise.
- The foreign person or the person's employer must be engaged in an "active" investment in the United States. To be characterized as active, the business underlying the investment must represent a real operating enterprise productive of some service or commodity. For example, an investment in a manufacturing facility would be an active investment, but an investment in undeveloped land for its potential appreciation in value would not be an active investment.
- The investment of the foreign person or the person's employer must be "substantial." An investment is substantial if the investor personally has at risk sufficient funds to establish or develop the enterprise. Although no particular dollar amount is required, in a small to medium-size business, the investor should have personally at risk approximately one-half of the funds necessary to commence operations. The amount at risk can be proportionately smaller for larger businesses.
- The business the foreign person invests in or the person's employer must either employ U.S. workers or be capable of creating job opportunities for U.S. workers.
- The foreign person must fulfill an essential role in the enterprise. If the foreign person is not an employee, the person must own a majority ownership interest (i.e., at least 50 percent of the enterprise.) If the foreign person is an employee, the person must serve in a managerial capacity or in a technical capacity for the U.S. enterprise or must supervise persons in technical positions with respect to the U.S. enterprise.

An application for an E visa is usually made at a U.S. consulate abroad. The basic procedure is to submit an official application (Form OF-156) with a passport and supporting documentation reflecting the applicant's qualifications under the desired E visa category. It is also

possible to apply for an E visa through the USCIS. The USCIS application process usually takes longer to complete. The Immigration and Naturalization Service and U.S. consulates do not always reach the same conclusion on granting E visas, and not all consulates will accept USCIS determinations.

d. Visa Type: H-1B (Specialty Occupations) Visa

The H-1B visa is often used by companies temporarily to employ foreign persons who will work in a specialty occupation. An H-1B visa is usually granted for periods of up to three years. When need is demonstrated, an extension of up to an additional three years, for a total maximum stay of six years, is possible. Note that there is a limited number of H-1B visas each fiscal year, and often these numbers are exhausted early in the year.

Requirements for an H-1B Visa

The following requirements must be satisfied to obtain an H-1B visa:

- The foreign person must be engaged in an occupation that requires theoretical and practical application of a body of highly specialized knowledge or attainment of a bachelor's or higher degree in a specific field; and
- The position to be filled in the United States must be of sufficient complexity that it requires a person with specialized knowledge requiring at least a four-year degree.

An employer seeking to employ a foreign person in a specialty occupation must file Form I-129 and its H supplement with the USCIS. The form must be accompanied by documentation demonstrating the applicant's qualifications for the H-1B visa and proof of filing a Labor Condition Application (i.e., that the applicant will be paid the prevailing—average—wage for that position in a particular geographic area). Premium processing (adjudication within 15 days) is available for H-1B visas. April 1 is the first day that employers can file H-1B petitions. If approved, those H-1Bs take effect on October 1 of that same year.

e. Visa Type: H-3 (Training) Visa

The H-3 (training) visa is often used by U.S. companies who want to bring foreign nationals to the United States to obtain training that is not otherwise available in the foreign national's home country. The training program must provide classroom training or a combination of classroom training and some limited on-the-job training.

Requirements for the H-3 Visa

- The sponsoring U.S. employer must have an established training program that includes classroom training. A detailed description of the program will be required.
- The purpose of the program must be to provide training that is not otherwise available in the applicant's home country. It cannot be used to train the employee for a U.S. position with the employer.
- Any productive employment must be incidental to the training.

An employer seeking to obtain an H-3 visa for a foreign national must file Form I-129 and its H-1 supplement with the USCIS. Premium processing (adjudication within 15 days) is available for H-3 visas at an additional cost of $1000. An H-3 visa can be initially granted for up to two years.

f. Visa Type: L-1 (Intracompany Transferee) Visa

The L-1 (intracompany transferee) visa enables companies with operations abroad to transfer employees temporarily to the United States to assist in local operations. If the foreign company is commencing activities in the United States, an L-1 visa is granted for one year. If the company has existing operations in the United States, an L-1 visa may be initially granted for up to three years. Certain extensions of the term of an L-1 visa may be available.

Requirements for an L-1 Visa

The following requirements must be satisfied to obtain an L-1 visa.

- Foreign person sought to be transferred to the United States must have been employed abroad in an executive or managerial capacity or in a capacity involving "specialized knowledge" on a full-time basis for at least one of the last three years preceding the visa application. Specialized knowledge refers to particular knowledge of the employer's product, service, and equipment and to their application in international markets.
- The U.S. company that will employ the recipient of the L-1 visa must be the same company for which the employee has worked abroad or a parent, subsidiary, or affiliate of that company.
- The foreign person's employment in the United States does not have to be in a capacity similar to that in which the person was employed abroad but must be in an executive or managerial capacity or one involving specialized knowledge.
- Both the U.S. company and its parent, subsidiary, or affiliate abroad, must be engaged in active business operations throughout the period the employee remains in the United States. The mere presence of an agent or office either in the United States or abroad is not sufficient.

An employer seeking to obtain an L-1 visa on behalf of an employee must file Form I-129 and its L supplement with the USCIS. Note, Canadians may file for an L-1 visa at the border. The petition should include supporting documentation demonstrating the applicant's qualifications for the L-1 visa. If the U.S. operation is commencing activities, the employer must provide additional information, including evidence that a physical location for the operation has been secured, evidence of preliminary contracts that demonstrate that the new operation has customers, and evidence that the foreign employer or affiliate has invested sufficient funds to pay the wages of the transferred employees.

An expedited procedure to obtain L-1 visas is available to an employer that seeks to transfer a number of employees to the United States. Rather than submit individual L-1 applications on behalf of each employee, the employer may submit a "blanket application" on behalf of all of the employees. To be eligible for a blanket application, the employer must currently maintain operations at a minimum of three sites in the United States or abroad; the U.S. operation must have been conducted for at least one year; and the employer must have

obtained 10 L-1 visas in the past year, have had annual U.S. sales of at least $25 million, or have employed a workforce in the United States of at least 1000 employees.

g. Visa Type: TN (Trade NAFTA) Visas

Foreign nationals who are Canadian or Mexican citizens may qualify for a TN work visa. This visa category is reserved for individuals from those countries who are coming to the United States to work in professions or areas of specialty that are specifically identified as being covered by the TN category.

Requirements for the TN Visa

- Foreign national must be a citizen of either Canada or Mexico.
- Foreign national must be coming to the United States to work in one of the listed professions or areas of specialty.
- The foreign national must demonstrate that he had the credentials required under the TN job category in which working.

Canadians can apply for a TN visa either at the border or through USCIS. Mexican citizens cannot apply for their TN at the border, but must instead apply through the U.S. consulate. The TN visa can be granted for an initial period of three years. Both Mexican and Canadian TN visa holders can process their extensions through USCIS while remaining in the United States. There are no outside limits on the total period of stay for a TN visa holder.

Appendix 2

Outlines of Certain State Exemptions

The exemptions from registration and disclosure in the states that regulate the offer and sale of franchises are far from uniform. Indeed, some exemptions apply to both registration and disclosure, and others only to registration. Three general categories of exemption are (1) fractional franchise exemptions, (2) large franchisor exemptions, and (3) sophisticated franchisee exemptions. Below is a survey of how these types of exemptions are currently addressed in a number of states:

I. Fractional Franchise Exemptions

California.

Experience:

- Can be met by franchisee or, if franchisee is not a natural person, an existing director, officer, or managing agent of the franchisee who has held that position for at least the last 24 months
- Must have been engaged in a business offering products or services substantially similar or related to those to be offered by the franchised business for at least 24 months prior to the grant of the franchise

Anticipated Sales:

- Parties in good faith anticipate at the time the agreement is reached that sales resulting from the franchised business will not represent more than 20 percent of the franchisee's total sales in dollar volume on an annual basis.

Filing Requirements:

Notice of exemption must be filed and filing fee paid for each calendar year in which one or more of these franchises is sold.

Other Conditions:

- New product or service is substantially similar or related to the product or service being offered by prospective franchisee's existing business;
- Franchised business is to be operated from same business location as existing business; and
- Franchisee is not controlled by the franchisor.[1]

Illinois.

Experience:

- Can be met by franchisee or a current director or executive officer of the franchisee
- Has been in the type of business represented by the franchise relationship for more than two years

Anticipated Sales:

- Parties anticipated or should have anticipated at the time the agreement is reached that sales resulting from the franchised business will not represent more than 20 percent of the franchisee's total sales in dollar volume for at least one year after the franchisee begins selling the goods or services.[2]

Indiana.

Experience:

- Can be met by franchisee or any of its officers or directors at the time the contract is signed
- Has been in the type of business represented by the franchise or a similar business for at least two years

Anticipated Sales:

- Parties anticipated or should have anticipated at the time the agreement is reached that franchisee's gross sales derived from the franchised business during the first year of operations will not exceed 20 percent of the franchisee's gross sales of all the franchisee's business operations.[3]

Michigan.

Experience:

- Can be met by an individual directly responsible for the operation of the franchise or a person involved in the management of the prospective franchisee, including a director, executive officer, or partner
- Has been directly or indirectly engaged in the type of business represented by the franchise relationship for at least two years

Anticipated Sales:

- Parties have reasonable grounds to believe, at the time the sale is consummated, that franchisee's gross sales in dollar volume from the franchise will not represent more than 20 percent of the franchisee's combined business operations.

Disclosure: If the franchisor has a disclosure statement in compliance with the laws of another state or the FTC Rule, franchisor must comply with disclosure requirements of Michigan law.

Other Conditions:

- Prospective franchisee is presently engaged in an established business of which the franchise will become a component.[4]

Minnesota.

Experience:

- Can be met by franchisee or any of the principal officers or directors of the franchisee
- Has been in the type of business represented by the franchise for more than two years

Anticipated Sales:

- Parties anticipated or should have anticipated at the time of the agreement that sales arising from the relationship would represent no more than 20 percent of the franchisee's dollar sales volume.[5]

Virginia.

Experience:

No experience requirement.

Anticipated Sales:

- Sales account for less than 20 percent of the retailer's gross sales

Other Conditions:

- Applies to existing retailers of goods or services
- Grant is of the right to use a marketing plan or system to promote the sales or distribution of goods or services that are incidental and ancillary to the principal business of the retailer (20 percent sales level is deemed incidental and ancillary).[6]

II. Large or "Seasoned" Franchisor Exemptions

California.

Net worth:

- Franchisor has audited net worth of not less than $5 million;
- Franchisor has an audited net worth of not less than $1 million and its parent has an audited net worth of not less than $5 million; or

- Franchisor has an unaudited net worth of not less than $1 million, its parent has an audited net worth of not less than $5 million, and parent guarantees obligations of franchisor.

Experience:

Franchisor or parent complies with one or more of following throughout preceding five years, or complies with one of following during part of period and one or more of following during balance of period:

- Franchisor or parent has had at least 25 franchisees or
- Franchisor or parent has conducted the business that is the subject of the franchise.

Disclosure:

At least 10 business days before signing an agreement or receiving consideration, franchisor must provide disclosure to prospective franchisee. Disclosure is more limited than that required by the FTC Rule. Additional disclosure is required in the event of a material modification of an existing franchise agreement.

Filing Requirement:

Notice of exemption must be filed and filing fee paid for each calendar year in which exemption is claimed.[7]

Illinois.

Illinois has two exemptions for large franchisors:

Net worth:

- Franchisor has audited net worth of not less than $15 million; or
- Franchisor has an unaudited net worth of not less than $1 million and its 80 percent or more parent corporation has audited net worth of not less than $15 million.

Experience:

No experience requirement.

Disclosure:

Franchisor must comply with disclosure requirements of Illinois law.

Filing Requirement:

None.[8]

Net worth:

Same as California.

Experience:

- Franchisor or parent has had at least 25 franchisees throughout past five-year period.
- Up to three years of required experience can be fulfilled if franchisor has conducted substantially same business as franchise.

Disclosure:

Franchisor must provide prospective franchisee with a disclosure document in the FTC Rule format.

Filing Requirement:

Franchisor must file the following annually:

- cover letter with specific information about compliance;
- copy of current disclosure document;
- consent to Service of Process; and
- certification page.[9]

Indiana.

Net worth:

In both cases net worth determined by financial statements certified by independent CPA.

- Franchisor has net worth of not less than $5 million or
- Franchisor has a net worth of not less than $1 million, and its 80 percent or more parent has a net worth of not less than $5 million.

Experience:

- Franchisor or 80 percent or more parent has had at least 25 franchisees throughout past five-year period or
- Franchisor or 80 percent or more parent has conducted the business that is the subject of the franchise continuously for not less than five years.

Disclosure:

At least 10 days before signing an agreement or receiving consideration, franchisor must provide disclosure to prospective franchisee. Disclosure is more limited than that required by the FTC Rule.

Filing Requirement:

None[10]

Maryland.

Net worth:

- Franchisor has audited net equity of not less than $10 million or

- Franchisor has audited net equity of not less than $1 million, its 80 percent or more parent has audited net equity of not less than $10 million, and parent guarantees obligations of franchisor.

Experience:

Franchisor had at least 25 franchisees conducting same franchised business at all times during preceding five-year period.

Disclosure:

Exemption is from registration only, not from disclosure requirements.

Filing Requirement:

Franchisor must file the following annually:

- notice of exemption at least 10 business days before offer or sale of franchise;
- consent to Service of Process;
- undertaking to file additional information upon request;
- filing fee;
- financial statements;
- representation that franchisor meets required experience component; and
- copy of disclosure document.[11]

New York.

There are two large franchisor exemptions in New York.

Exemption No. 1: Net worth:

- Franchisor has audited net worth of not less than $5 million or
- Franchisor has audited net worth of not less than $1 million, and its parent has an audited net worth of not less than $5 million.

Experience:

No experience requirement.

Disclosure:

At least seven days before signing an agreement or receiving consideration, franchisor must provide disclosure to prospective franchisee. Disclosure is more limited than that required by the FTC Rule.

Filing Requirement:

Franchisor must file the following:

- application exemption form;
- identity and business experience of persons affiliated with the franchisor; and
- consent to Service of Process.

Exemption No. 2: Net worth:

- Franchisor has audited net worth of not less than $15 million or
- Franchisor has audited net worth of not less than $3 million, and its parent has audited net worth of not less than $15 million.

Experience:

None

Disclosure:

At least seven days before signing an agreement or receiving consideration, Franchisor must provide disclosure to prospective franchisee. Disclosure is more limited than that required by the FTC Rule.

Filing Requirement:

None[12]

North Dakota.

Net worth:

- Franchisor has audited net worth of not less than $10 million or
- Franchisor has audited or unaudited net worth of not less than $1 million, its 80 percent or more parent has audited net worth of not less than $10 million and parent guarantees obligations of franchisor.

Experience:

- Franchisor or its 80 parent or more parent has had at least 25 franchisees throughout past five-year period, or
- Franchisor or its 80 percent or more parent has conducted the business that is the subject of the franchise continuously for not less than five years.

Disclosure:

At least seven days before signing an agreement or receiving consideration, franchisor must provide disclosure to prospective franchisee. Disclosure is more limited than that required by the FTC Rule. Additional disclosure is required in the event of a material modification of an existing franchise agreement.

Filing Requirement:

Franchisor must file the following annually:

- notice of exemption;
- filing fee;

- name of franchisor and parent, business address, name and address of agent for service of process, business form;
- copy of typical franchise agreement; and
- information sufficient to establish compliance with net worth and experience components.[13]

Rhode Island.

Net worth:

- Franchisor has audited net worth of not less than $10 million or
- 80 percent or more parent has audited net worth of not less than $10 million and parent guarantees obligations of franchisor and consents to service of process in Rhode Island.

Experience:

Franchisor or 80 percent or more parent has had at least 25 franchisees at no fewer than 25 locations throughout past five-year period.

Disclosure:

Exemption is from registration only, not from disclosure requirements. Prospective franchisee must receive disclosure document at least 10 business days before signing an agreement or paying fee.

Filing Requirement:

Franchisor must file the following annually:

- notice of exemption
- filing fee.[14]

Washington.

Net worth:

- Franchisor has audited net worth of not less than $5 million, or
- Franchisor has audited net worth of not less than $1 million, and its 80 percent or more parent has audited net worth of not less than $5 million.

Experience:

- Franchisor or parent has had at least 25 franchisees throughout past five-year period, or
- Franchisor or parent has conducted the business, which is the subject of the franchise continuously for not less than five years.

Initial investment:

Must require an initial investment by the franchisee of more than $100,000.

Disclosure:

Exemption is from registration only, not from disclosure requirements.

Filing Requirement:

Franchisor must file the following annually:

- notice of exemption
- filing fee[15]

III. Sophisticated Purchaser Exemptions

State	Existing Franchisee	Franchisor Insider	High Net Worth Franchisee	Substantial Investment	Experienced Franchisee
California	✓	✓			✓
Hawaii	✓				
Illinois		✓	✓	✓	
Maryland	✓			✓	
New York	✓				
Rhode Island	✓	✓	✓		
South Dakota		✓	✓	✓	
Washington	✓	✓	✓		
Wisconsin	✓			✓	

Notes

1. California Franchise Investment Law, Cal. Corp. Code § 31108 (2012).
2. 815 Ill. Comp. Stat. 705/3 (1992).
3. Ind. Code §§ 23-2–25-1 (2011).
4. Mich. Comp. Laws § 445.1506(h) (1979).
5. Minn. Stat. § 80C.03(f) (1996).
6. Virginia Retail Franchising Act, Va. Code Ann. § 13.1-559B (West 2012).
7. California Franchise Investment Law, Cal. Corp. Code § 31101 (2012).
8. 1987 Ill. Laws, ch. 85-551, § 70518(a).
9. Regulations under the Franchise Disclosure Act, Ill. Admin. Code tit. 14, § 200.202(e) (2012).
10. Ind. Code, § 23-2-2.5-3 (2011).
11. Md. Code Regs. 02.02.08.10D (2012).
12. N.Y. Gen. Bus. Law §§ 684 (2)–(3) (2012).
13. North Dakota Franchise Investment Law, N.D. Cent. Code Ann. § 51-19-04 (1) (West 2011).
14. Rhode Island Franchise and Distributorship Investment Regulations Act, R.I. Gen. Laws § 19-28.1-6(a) (2012).
15. Washington Franchise Protection Act, Wash. Rev. Code § 19.100.030(4)(b)(i) (2012).