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**TITLE**

**The Armenian Franchise Registration Requirement and the  
Application Form**

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## INTRODUCTION

“A franchise is a type of license that a party (*franchisee*) acquires to allow them to have access to a business's (*the franchisor*) proprietary knowledge, processes, and trademarks in order to allow the party to sell a product or provide a service under the business's name”.<sup>1</sup>

The concept of franchising dates back to the 1880s, where Isaac Singer, the founder of I.M. Singer & Company became the first person to patent a practical, widely-used sewing machine, and then created franchises to successfully distribute his trademarked sewing machines to larger areas.<sup>2</sup>

As more people started buying and selling franchises, it grew to a point where some developed countries drafted specific franchise laws to better regulate this transaction.

Today, franchising businesses encompass more than 50% of the retail and service revenue in the United States.<sup>3</sup> The primary reason most entrepreneurs turn to franchising is because it allows them to expand their business without the risk of debt or the cost of equity.<sup>4</sup>

Franchise contracts are complicated and they vary for each franchisor. They are temporary, and do not signify business ownership by the franchisee. Depending on the franchise contract, franchise agreements typically last from five to thirty years, with serious penalties or consequences if a franchisee violates or prematurely terminates the contract.<sup>5</sup>

There are two ways the franchisor can interact with the franchisees, either via:

- *Direct franchising*, whereby the sales and support services are provided to individual franchisees by the franchisor;<sup>6</sup> or

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<sup>1</sup> Investopedia, Section on Franchising, *What is a Franchise*, available at <https://www.investopedia.com/terms/f/franchise.asp> (last visited May 10, 2019).

<sup>2</sup> Bplans, The History of Franchising as We Know It, *The 1880s*, available at <https://articles.bplans.com/the-history-of-franchising-as-we-know-it/> (last visited May 10, 2019).

<sup>3</sup> Acceler8Success, Franchising in the USA – Facts and Figures, section on Franchise Statistics, available at, <https://franchisessentials.com/2010/01/23/franchising-in-the-usa/>

<sup>4</sup> Entrepreneur, The 9 Advantages of Franchising, section on Capital, available at, <https://franchisessentials.com/2010/01/23/franchising-in-the-usa/> (last visited May 10, 2019).

<sup>5</sup> Investopedia, Section on Franchising, *Franchise Basics and Regulations*, available at <https://www.investopedia.com/terms/f/franchise.asp> (last visited May 10, 2019).

<sup>6</sup> Entrepreneur, What is a Master Franchisee, available at <https://www.entrepreneur.com/article/72380> (last visited May 10, 2019).

- *Master franchise*, through which the franchisor contracts with a master franchisee who provides these services to franchisees in a specified territory (this can sometimes include countries). The master franchisee typically pays the franchisor a significant initial payment and then receives the initial fees and royalties from franchisees in that specified territory.<sup>7</sup>

Every country creates rules to regulate how business is conducted including taxation, property, employee's rights, environmental protection and many other laws. When a business contemplates expanding into a country, they need to know what is legally required of them. Depending on the country, business regulations are packaged in different ways depending on the legal system each country follows. There are Common Law countries, Civil Law countries, and Customary (religious) Law countries co-existing with other legal systems.<sup>8</sup> With international franchising, the franchisor's country and the target country are quite likely to come from different traditions, which would give rise to issues some of which are legal.<sup>9</sup>

One important point to understand before moving to a new country is whether there are any laws specifically regulating franchising in that country, considering that some countries regulate franchising specifically, while others do this as part of the general commercial environment.<sup>10</sup> For example in Australia franchising is regulated through mandatory code of conduct, which is a regulation under the Competition and Consumer Act, while In Malaysia there is a specific Franchise Act regulating all legal matters concerning franchising.<sup>11</sup>

Businesses contemplating moving to a new country need to know what will be legally required of them. Even where there are specific franchise laws, general laws still need to be obeyed.<sup>12</sup>

Even though franchising can be either domestic or international, this paper will concentrate on international franchising because it is the dominant form of franchising in Armenia.

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<sup>7</sup> Entrepreneur, What is a Master Franchisee, available at <https://www.entrepreneur.com/article/72380> (last visited May 10, 2019).

<sup>8</sup> Future Learn, Section on International Franchise Regulations, available at <https://www.futurelearn.com/courses/international-franchise-law/0/steps/13653> (last visited May 10, 2019).

<sup>9</sup> Id.

<sup>10</sup> Id.

<sup>11</sup> Id.

<sup>12</sup> Id.

The Republic of Armenia has no specific law on franchising in itself, instead it assigns a separate chapter in the Civil Code to regulate this transaction.

In Article 970 (2) of the Civil Code of the RA, the legislator requires the registration of the franchise agreement with the State Register of Legal Entities prior to conducting the transaction, and without such registration Article 302 (1) renders such an agreement void.

However, in practice, there is no registration procedure to comply with, which makes this provision more of an obstacle rather than a protective instrument, and evidently renders all franchise agreements void.

To solve this issue, we must first understand the reason why there is a franchise agreement Registration requirement in the first place, and if such a requirement was a necessity under the Armenian setting, how can we model it to reflect the best possible outcome for a business.

We should also distinguish franchising from similar protective tools that function properly in Armenia such as a *license agreement* whereby the Intellectual Property rights of a business can be registered and protected by the *Intellectual Property Agency* and then licensed to another local business to conduct operations under the licensed IP. This would raise a question. If the IP rights of a business were properly protected by the license agreement, why do we still need to regulate franchising?

The answer lies in the nature of franchising. Franchising protects a wider range of rights, with the aforementioned license agreement forming a part of the entire franchise agreement.

In a license agreement, the licensor has a limited control over the licensee. By providing a license, the licensor grants the licensee the right to use the brand and other IP, however the operations of the licensee are *not controlled* by the licensor which would expose the latter to a devaluation of the brand quality.<sup>13</sup> On the other hand, in a franchise, the franchisor can have strict *quality control* provisions and *staff training* requirements to protect its brand from bad management by the franchisee.<sup>14</sup> Thus, we see that franchising regulates the entire relationship

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<sup>13</sup> Azrights, Licensing And Franchising, What Is The Difference And Does It Matter? Available at, <https://azrights.com/media/news-and-media/blog/business-2/2014/12/licensing-and-franchising-what-is-the-difference-and-does-it-matter> (last visited May 10, 2019).

<sup>14</sup> Id.

between the franchisee and the franchisor, whereas licensing protects the right to use the brands or other Intellectual Property provided by one party to the other.

For some companies not having a franchise agreement could be a deal breaker, because they require strict quality control provisions and a license agreement would not cover those rights. An example would be the famous food franchise McDonalds.<sup>15</sup> We see that McDonalds relies on franchising as a predominant way to do business having 80% of its business through franchises while the remainder is owned and operated by the company.<sup>16</sup> Thus, having a franchise agreement can protect the franchise system as a whole, including the brand and integrity of the operating system while maintaining the solid reputation of the company.<sup>17</sup>

To encourage these businesses to operate in Armenia, there should be a certain level of protection provided by the legal and regulatory framework, and without such protection a franchisor would reconsider investing in Armenia and the project might end at the planning stage.

Another issue that frequently rises is when franchisees *do not read or understand* their franchise agreement before signing on the dotted line, and then discover, after the fact, that the deal they are now legally bound to is not quite what they thought they were getting.<sup>18</sup>

Taking the previous issues into consideration, this paper aims at researching and suggesting practical solutions to be adopted when creating franchise registration forms through which businesses contemplating the expansion in Armenia must file to the State Registrar to further protect their interests.

The forms should be coupled with exhibits that include requirements for the franchisor to disclose to the franchisee regarding the franchisor's company and the proposed sale of the franchise. The forms and exhibits will not disturb the hospitable business environment in

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<sup>15</sup> Azrights, Licensing And Franchising, What Is The Difference And Does It Matter? Available at, <https://azrights.com/media/news-and-media/blog/business-2/2014/12/licensing-and-franchising-what-is-the-difference-and-does-it-matter> (last visited May 10, 2019).

<sup>16</sup> Market Realist, What is a franchise and how do McDonald's franchise agreements work? Available at, <https://articles.marketrealist.com/2013/12/franchise-mcdonalds-franchise-agreements-work> (last visited May 10, 2019).

<sup>17</sup> Entrepreneur, 10 Things about Franchise Contracts- Part 1, available at, <https://www.entrepreneur.com/article/201514> (last visited May 10, 2019).

<sup>18</sup> The Balance Small Business, Franchise Agreement vs. Franchise Disclosure Document, available at, <https://www.thebalancesmb.com/franchise-agreement-vs-franchise-disclosure-document-1350607> (last visited May 10, 2019).



Armenia, considering that disclosure requirements for simple operational and business history information about the franchisor cannot place a heavy burden on them, while at the same time it will protect the franchisees from entering into transactions against their interests because of the lack of certain information needed to make a better educated decision, thus saving businesses time and money that could have been invested elsewhere.

The suggestions are going to be provided after studying the *2008 Franchise Registration and Disclosure Guidelines* adopted by the *North America Securities Administrators Association, Inc.* (“NASAA”).

The US is one of the leading nations regulating franchise transactions with specific franchise laws comprised of a combination of federal and state laws that govern the offer and sale of franchises.<sup>19</sup> The Federal Franchise Rule is enforced by the Federal Trade Commission (“FTC”). The central requirement of the Federal Franchise Rule relates to a franchisor's disclosure of a Franchise Disclosure Document (“FDD”) prior to the offer or sale of any franchise.<sup>20</sup>

This prior disclosure requirement protects the franchisee from rushing into buying a franchise before getting familiarized with the extensive terms and conditions provided by the franchisor.

An FDD is typically comprised of hundreds of pages encompassing 23 Items with additional Exhibits following the Items.<sup>21</sup> Common exhibits include: audited financial statements from the franchisors, the franchise agreement and personal guaranty to be signed, and more.<sup>22</sup>

The historical lack of regulation in franchising transactions enabled unscrupulous individuals to perpetuate scams under the pretense of running a franchise. However, after the FTC instituted the requirement to form the FDD, this problem was solved by providing the buyers with vetted and validated information that can be used to make a decision.<sup>23</sup>

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<sup>19</sup> Internicola Law Firm, What Are the Franchise Laws, available at, <https://www.franchiselawsolutions.com/how-to-franchise/franchise-laws.html> (last visited May 10, 2019).

<sup>20</sup> Id.

<sup>21</sup> Franchise Direct, States That Require FDD Registration or Filing, available at, <https://www.franchisedirect.com/information/states-that-require-fdd-registration-or-filing> (last visited May 10, 2019).

<sup>22</sup> Id.

<sup>23</sup> Forbes, How to Read a Franchise Disclosure Document, available at, <https://www.forbes.com/sites/chrismyers/2018/07/08/how-to-read-a-franchise-disclosure-document/#2711b42433da> (last visited May 10, 2019).

However, while the FTC requires the FDD to be provided 14 days prior to signing the franchise agreement, the Federal Franchise Rule leaves compliance largely to the franchisors as no federal registration of the FDD is required.<sup>24</sup> Because of this, several US states have taken steps to further protect prospective franchisees within their borders by enacting state-specific regulations, such as *registering the FDD* with the state government agency before operating in that particular state.<sup>25</sup> While some other US states did not adopt the registration requirement, instead they required the franchisor to *file its FDD with the state* before operating in that specific state, and to have it renewed every following year.<sup>26</sup> This requirement is lightly regulated in comparison with registration of the FDD, in these states there is usually some kind of specific law governing how business opportunities are offered and sold within the state, but not franchise-specific rules.<sup>27</sup>

In Armenia however, the situation is different where instead of having a disclosure requirement like the FDD and the obligation to register it with the relevant state agency, there is a requirement to instead *register the franchise agreement with the State Register*. If applied properly, this could prove a useful tool to protect the rights of franchisees against exploiting franchisors. This could also protect franchisees from their own missteps, because having a potent and accurate franchise agreement registration form would allow franchisees consider subjects of importance they might have failed to discuss during the negotiations period with the franchisor (litigation history, bankruptcy, or other matters of importance). This will fulfil the purpose of the registration requirement provided by the Armenian legislator.

This paper will not suggest creating a Franchise Disclosure Document in Armenia similar to that of the United States. The reason being that the market in Armenia is not as heavily regulated as it is in the US, another reason is that the law in Armenia regarding franchising is not fully developed yet to warrant a heavy regulation of a massive document similar to the FDD. The US has a long history regulating franchising, the Amended Franchise Rule represents the

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<sup>24</sup> Franchise Direct, States That Require FDD Registration or Filing, available at, <https://www.franchisedirect.com/information/states-that-require-fdd-registration-or-filing> (last visited May 10, 2019).

<sup>25</sup> Id.

<sup>26</sup> Franchise Direct, States That Require FDD Registration or Filing, available at, <https://www.franchisedirect.com/information/states-that-require-fdd-registration-or-filing> (last visited May 10, 2019).

<sup>27</sup> Id.

culmination of a 12-year amendment process conducted by the FTC and its staff. This long period of amendment and adjustment is what gave rise to the Franchise Disclosure Document, however, it was also criticized because it only mandates pre-sale disclosure and does not require any type of federal registration or approval.<sup>28</sup> This prompted several US states to impose franchise registration requirements with relevant state agencies as was discussed above.

The following chapters will demonstrate why franchise registration is important and why having certain requirements for the franchisor to abide by, is essential for both businesses and the economy overall. The necessary issues and policies will be discussed, proposing content for the creation of the registration forms, and including exhibits that the franchisor must fill and attach to the application form. These suggestions will be based on the NASAA requirements and they will be appropriated to the Armenian setting. The main aim of these documents should be to verify that the parties have negotiated issues of paramount importance, while requiring the franchisor to disclose certain information necessary for the prospective franchisee to make the final decision regarding the franchise purchase.

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<sup>28</sup> Kevin J. Moran & Max J. Schott II, *The Amended FTC Franchise Rule: Much Ado about Nothing?*, 10, *The Franchise Lawyer* 1 (2007).

## CHAPTER 1

### POLICIES THAT NEED CONSIDERATION IN FRANCHISING

When creating a registration form we must aim at avoiding unnecessary and overburdening requirements that would ultimately render the franchisor at a disadvantage, because when the business environment is inhospitable for the franchisor they will reconsider expansion in Armenia which would potentially place prospective franchisees at a disadvantage offering more concessions.

The following points must be addressed and understood before initiating the creation of the form:

- 1. Registration of amendments to the franchise agreement.*

Some countries require franchisors to register with governmental authorities and to update their records on a continuing basis. Compliance with this requirement can be both costly and burdensome.<sup>29</sup>

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<sup>29</sup> Who's Who Legal, Which EU Jurisdictions Most Heavily Regulate Franchising? Section on registration, available at, <https://whoswholegal.com/news/features/article/30097/which-eu-jurisdictions-heavily-regulate-franchising> (last visited May 10, 2019).

In Armenia we have Article 978 of the Civil Code stating that every time any amendment takes place in the contract, that amendment must be registered with the State Register to be able to invoke such amendment against third parties. When we consider the nature of franchise contracts, we see that they are usually non-negotiable, this depends on the franchisor and the leverage they have.<sup>30</sup> This means that the contract is not likely to be amended every now and then, thus, for our purposes, we see that this requirement does not require the franchisor to re-file for registration on a continuing basis after the passage of a certain amount of time (usually an annual procedure in the US).<sup>31</sup> Instead, it only requires refiling after an amendment has been made to the agreement, which is less likely to happen, thus maintaining a less regulated while still functioning method of protection.

## *II. Disclosure timing requirements.*

One thing that has a great significance in the US and must be taken into consideration is the period of which a franchisor must provide the franchisee with the disclosure document prior to signing a binding agreement or making a payment or any other affiliate connection with the proposed sale of the franchise. The FTC requires the FDD to be provided 14 days prior to signing an agreement.<sup>32</sup> This requirement is necessary for protecting franchisees from arbitrarily signing an agreement without having the time to review the terms and conditions of the franchisor. However, the Federal Franchise Rule leaves compliance with this regulation largely to the franchisors as no federal registration of the FDD is required. This was the reason why several states have taken steps to further protect prospective franchisees within their borders by enacting certain protective regulations.<sup>33</sup> The 14-day period begins with the signing of a formal receipt. The receipt does not establish any obligation on the franchisee's part, it simply acknowledges that they have received the FDD.<sup>34</sup>

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<sup>30</sup> Entrepreneur, 10 Things about Franchise Contracts- Part 1, available at, <https://www.entrepreneur.com/article/201514> (last visited May 10, 2019).

<sup>31</sup> The Franchise Guru, available at, <https://franchiseatty.com/2018/03/07/state-filing-franchise-disclosure-document-registration-and-requirements/> (last visited May 10, 2019).

<sup>32</sup> Franchise Direct, States That Require FDD Registration or Filing, available at, <https://www.franchisedirect.com/information/states-that-require-fdd-registration-or-filing> (last visited May 10, 2019).

<sup>33</sup> Id.

<sup>34</sup> Franchise Direct, Basics of the Franchise Disclosure Document (FDD): A Primer on This Important Paperwork, available at, <https://www.franchisedirect.com/information/guidetobuyingfranchise/basics-of-the-franchise-disclosure-document-fdd/29/195/> (last visited May 10, 2019).

To apply this useful tool in Armenia, the State Register must oblige the franchisor to send a receipt document to the franchisee a certain amount of days prior to signing the franchise agreement. Signing this receipt form *will not place any obligations* on the parties, it will only indicate that the franchisee has contemplated the purchase of the franchise and has had the chance to thoroughly research the background of the franchising system. This action must be taken a certain amount of days prior to the signature of the agreement, rejecting any applications with receipts signed at a period less than the required amount.

At first glance the 14 day rule adopted by the FTC might look like a long period, however judging by the extensive and complicated nature of the FDD, this period is justified. In Armenia a shorter period such as a 10 day period would be sufficient to study the required documents for prospective franchisees having enough time to thoroughly study the franchise agreement and the adjoining documents provided to them.

Another issue this period requirement might solve is that prospective franchisees usually have competitors in a certain geographical area, this competition might blind them from making an informed decision. This will protect prospective franchisees rushing into arbitrarily signing the agreement and regretting it later. Because when there is a waiting period, the parties are still capable of backing out of the contract without any repercussions. Only after this period expires will the contract be signed and the State register will accept the application.

### *III. Confidentiality in a franchise agreement conflicting with the registration requirement.*

In the US all of the information regarding the franchise is available to the public through the FDD which in turn is available to anyone interested in buying that franchise, either through websites<sup>35</sup>, or provided by the company to prospective franchisees.<sup>36</sup>

According to Charles Internicola (a National Business and Franchise Lawyer) registration states in the US treat the FDD much “like a stock or security” in that the FDD must be registered with the appropriate regulation body similar to how a stock must be registered with the Securities

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<sup>35</sup> For example, the website <<https://fdexchange.co>> charges a monthly fee to research and study FDDs.

<sup>36</sup> Investopedia, Section on FDD, Franchise Disclosure Document: Rights of the Franchisee, available at, <https://www.investopedia.com/terms/f/franchise-disclosure-document.asp> (last visited May 10, 2019).

and Exchange Commission before an Initial Public Offering where the public can become familiarized with the company.<sup>37</sup>

Moreover, in regards to protecting trade secrets in a franchise. These trade secrets are not provided in the FDD, not even in the franchise agreement. Instead, franchisors do not provide franchisees access to these trade secrets until after signing the franchise agreement in what is called the *operations manual*.<sup>38</sup>

The operations manual usually includes details that are *confidential* in nature, many franchisors are hesitant in providing the operations manual to potential franchisees in the first instance. After the franchisor can gauge better the seriousness of a potential franchisee, they usually provide the franchise agreement and disclosure documents before providing the operations manual. As an extra precaution, many franchisors require the potential franchisee to sign a *confidentiality or non-disclosure agreement* before providing a copy of the operations manual.

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Thus, there will be no harm in providing the State Register with information regarding the franchise agreement for registration, mainly because the trade secrets of a franchise are transferred to the franchisee by the operations manual (not the agreement), allowing franchisors to send the franchise agreement to any prospective franchisee without disclosing any trade secrets.

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<sup>37</sup> Franchise Direct, States That Require FDD Registration or Filing, available at, <https://www.franchisedirect.com/information/states-that-require-fdd-registration-or-filing> (last visited May 10, 2019).

<sup>38</sup> Legal Vision, Intellectual Property, available at, <https://legalvision.com.au/confidentiality-considerations-for-franchisors> (last visited May 10, 2019).

<sup>39</sup> Legal Vision, The Operations Manual Can Bind a Franchisee, available at, <https://legalvision.com.au/franchisors-guide-franchise-operations-manual> (last visited May 10, 2019).

## **CHAPTER 2**

### **PROTECTING THE PROSPECTIVE FRANCHISEE IN THE APPLICATION FORM**

The registration process is adopted to protect the prospective franchisee from potential misinformation, lack of information, or from any other financial harm, thus the form must include warning phrases to ensure that the prospective franchisee is not lacking the knowledge



of essential information when making the decision to buy a certain franchise system and committing to the obligations opposed by it.

The following protective statements have been provided after studying the NASAA franchise registration and disclosure guidelines.<sup>40</sup> They are written in capitalized letters to grab the attention of the reader and signify the importance of their content.

- I. First, there must be a disclaimer provided on the cover page stating the following:  
REGISTRATION OF THE FRANCHISE AGREEMENT AND THE ADJOINING DOCUMENTS BY THE STATE REGISTER OF LEGAL ENTITIES OF THE REPUBLIC OF ARMENIA DOES NOT MEAN THAT THE STATE REGISTER RECOMMENDS THE FRANCHISE OR HAS VERIFIED THE INFORMATION IN THIS AGREEMENT.

Such a disclaimer is intended to deflect liability away from the State Register and inform readers that the State Register does not verify the accuracy of the information mentioned in the agreement and the documents provided.

- II. The form must also include the following warning statements:
  - MANY FRANCHISE AGREEMENTS DO NOT ALLOW YOU TO RENEW UNCONDITIONALLY AFTER THE INITIAL TERM EXPIRES. YOU MAY HAVE TO SIGN A NEW AGREEMENT WITH DIFFERENT TERMS AND CONDITIONS IN ORDER TO CONTINUE TO OPERATE YOUR BUSINESS. BEFORE YOU BUY, CONSIDER WHAT RIGHTS YOU HAVE TO RENEW YOUR FRANCHISE, IF ANY, AND WHAT TERMS YOU MIGHT HAVE TO ACCEPT IN ORDER TO RENEW.

This will notify the first time franchisee of the risk factors that follow signing a franchise agreement without having a long term plan for the continuation of the business. Mainly protecting the franchisees that did not discuss the renewal requirements with the franchisors raising their awareness on an issue that requires prior determination and negotiation. The franchisor might not disclose such information not to discourage any prospective franchisees, making such a requirement a necessity.

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<sup>40</sup>NASAA, *2008 Franchise Registration and Disclosure Guidelines (Amended and Restated UFOC Guidelines)*, 3 (2008). Also available at <http://www.nasaa.org/wp-content/uploads/2011/08/6-2008UFOC.pdf>

- THE FRANCHISE AGREEMENT MIGHT BE GOVERNED BY A LAW OTHER THAN THE LAW OF THE REPUBLIC OF ARMENIA, AND THIS LAW MAY NOT PROVIDE THE SAME PROTECTIONS AND BENEFITS AS THE ARMENIAN LAW. YOU MAY WANT TO COMPARE THESE LAWS.

The nature of franchising allows it to become a tool for the expansion of a business internationally, and when parties from different countries draft a franchise agreement they must include a governing law clause to add certainty in any potential litigation. Local franchisees must be notified to make sure the laws of a different country will not be detrimental for their business.

- THE FRANCHISE AGREEMENT MIGHT REQUIRE YOU TO RESOLVE DISPUTES WITH THE FRANCHISOR BY [LITIGATION/ARBITRATION/MEDIATION] ONLY IN CERTAIN COUNTRIES. THIS MAY FORCE YOU TO ACCEPT A LESS FAVORABLE SETTLEMENT FOR DISPUTES. IT MAY ALSO COST YOU MORE TO [LITIGATE/ARBITRATE/MEDIATE] WITH THE FRANCHISOR IN A COUNTRY OTHER THAN THE REPUBLIC OF ARMENIA.

An international franchise agreement typically has a jurisdiction clause. And usually well-known franchises do not negotiate the terms of the agreement.<sup>41</sup> This might lead to a situation where the franchisee does not have the capability and the finance to sue in a different country. Knowing this might render the franchisee reconsidering a certain franchise and possibly looking for another, which is why notifying the franchisee with this statement is important prior to registration.

- THE FRANCHISOR MIGHT USE THE SERVICES OF ONE OR MORE *FRANCHISE BROKERS* OR REFERRAL SOURCES TO ASSIST THEM IN SELLING THEIR FRANCHISE. A FRANCHISE BROKER OR REFERRAL SOURCE REPRESENTS THEM, NOT YOU. THEY PAY THIS PERSON A FEE FOR SELLING THEIR FRANCHISE OR REFERRING YOU TO THEM. YOU SHOULD BE SURE TO DO YOUR OWN INVESTIGATION OF THE FRANCHISE.

Some franchisors sell their franchises through franchise brokers, the franchisee might rely on the broker's advice and representation when buying a certain franchise, with this disclaimer the

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<sup>41</sup> Entrepreneur, 10 Things about Franchise Contracts- Part 1, available at, <https://www.entrepreneur.com/article/201514> (last visited May 10, 2019).

franchisee will be warned about the connection between the franchisor and the broker, and will become aware about any misleading or incomplete information provided to them to accelerate the franchise purchase.

III. The form must also include a section stating about the *Effective Date* of the registration.

The State Register must fill in the “effective date” section taking into consideration the receipt form signed by the franchisee indicating the date all the required information have been disclosed to the franchisee. This way the State Registrar will check whether a certain period of time has passed after receiving the necessary documents regarding that franchise. If that period has not yet passed the application will be rejected.

With this requirement the State Registrar can make sure that the franchisee has had enough time to go through all the terms imposed by the contract.

This statement must be followed by another one and signed by the prospective franchisee as follows:

*I received all the documents required by the State Register which include the following Exhibits:*

*[The mandatory Exhibits must be included here].*

*Date: the date of applying to the State Register      Signature of prospective franchisee: \_\_\_\_\_*

## **CHAPTER 3**

### **INSTRUCTIONS FOR FRANCHISORS IN PREPARATION OF THE APPLICATION FORMS**

This chapter aims to provide instructions for the applicant in preparation for the application. NASAA has adopted similar instructions for the preparation of the FDD.<sup>42</sup>

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<sup>42</sup> NASAA, *2008 Franchise Registration and Disclosure Guidelines (Amended and Restated UFOC Guidelines)*, 4 (2008). Also available at <http://www.nasaa.org/wp-content/uploads/2011/08/6-2008UFOC.pdf>

The following points must be taken into consideration when preparing the application.

- I. The applicant must disclose all required information clearly, legibly, and concisely in a single document using plain English/Armenian. *Plain English/Armenian* means the organization of information and language usage understandable by a person unfamiliar with the franchise business. It incorporates short sentences; definite, concrete, everyday language; active voice; and tabular presentation of information, where possible. It avoids legal jargon, highly technical business terms, and multiple negatives.

This is important to take into consideration because not only lawyers and accountants read the disclosed documents, businessmen alike must be capable of reading these lengthy documents and fully comprehending what is included regarding their rights and obligations.

- II. The provided documents must be in a form that permits the franchisee to store, download, print, or otherwise maintain the documents for future reference.

Franchising involves numerous and complicated requirements and conditions the franchisee must abide by, and keeping a copy of all the documents provided could help in a case where litigation may arise involving such documents. This also aims at notifying the parties that any deals reached orally during negotiations will not be binding, unless it is in a written and storable form.

- III. Before furnishing the required documents, the franchisor must advise the prospective franchisee of the formats in which the documents are made available, any prerequisites for obtaining the documents in a particular format, and any conditions necessary for reviewing the documents in a particular format.

The reason behind such requirement is that some information regarding the documents might be available for the franchisee, and others might need to be purchased or provided by the franchisor in order to become fully familiar with their contents. The

franchisee must be aware of all the necessary information to make a well-educated decision regarding buying a franchise.

- IV. Separate documents (e.g. a confidential operations manual) must not make representations or impose terms that contradict or are materially different from the disclosed documents.

These confidential documents are not registered with the State Register, and they are not made public, which makes them vulnerable for exploitation by the franchisor. The law must prohibit any contradictions between these confidential documents and the registered documents, and in a case of contradiction, the registered documents must prevail.

- V. Use A-4 paper sheets for the disclosure of documents and other forms submitted to the State Register. The text of the Franchise Disclosure Document must be typed (not handwritten), clearly readable, and presented in at least 12 font size.

With the goal of making these documents comprehensive and easy to read, it is common sense to have them typed with an easily readable format.

- VI. When the applicant is a *master franchisor* seeking to sell franchises (sub-franchises), references in these requirements and instructions also refer to the master franchisee (sub-franchisor).

This means that the master franchisee here is considered a franchisor because of selling the franchise system to other franchisees. This puts the master franchisee on a similar ground with the franchisor because they have similar interests, and the risks potential franchisees face dealing with them are also similar, thus a similar treatment by the State Register is justified.

- VII. The offer of *master franchises* (sub-franchises) is an offer separate from the offer of *direct franchises* and requires a separate registration. A single application shall not register the sale of single unit and multi-unit franchises.

The reason why this requirement is important is to eliminate confusion when registering these applications considering the interrelated rights and obligations each contract creates.

- VIII. Master franchisees (sub-franchisors) must disclose the required information about the master franchisor, and to the extent applicable, the same information concerning the master franchisee (sub-franchisor).

The franchisee here is practically dealing with two franchisors, one is the master franchisee and the other is the master franchisor. If the franchisee has only the information regarding the master franchisee and not the master franchisor (or vice versa) there might be essential information missing in regards to the franchising system. The history or reputation of one of these franchisors might be sufficient to reconsider buying that certain franchise system.

- IX. Grossly deficient applications may be rejected summarily by the State Register as incomplete for filing.

The additional time reviewing the grossly deficient applications delays the processing of diligently prepared and pursued applications. It is not the function of the State Register to prepare, in effect, an applicant's inadequate application.

- X. When the law requires an amendment to be registered, the applicant must mark "Amendment Application" on the Application page. The applicant must also submit all documents required for an initial application, with additions to the previously filed documents. Changes must be clearly marked so that each change is noticed easily.

The application form must have a section where the applicant can mark the "Amendment Application", this way the State Register will easily identify the documents and proceed with the registration process. The changes should also be clearly marked and added to the previously filed documents and clearly marked to help locate each change faster considering that the provided documents might sometimes be extensive.

- XI. In order not to make the search of the disclosure requirements overburdening for the State Register, the franchisor will be required to refer to the relevant provision stated in the franchise agreement after each specific state requirement mentioned in these exhibits.

## **CHAPTER 4**

### **THE APPLICATION FORMS AND EXHIBITS**

This chapter will study how the necessary forms must be created to abide by the registration requirements after analyzing the *NASAA* guidelines and instructions adopted by the FTC and understanding the policies they uphold.<sup>43</sup>

It will also suggest exhibits the franchisor must provide to the prospective franchisee and their contents alongside the receipt document 10 days prior to signing the franchise agreement. With these exhibits, the franchisor will disclose all essential information the prospective franchisee will need to know in order to make an educated decision regarding the purchase of a particular franchise.

The franchisor must attach a copy of all proposed agreements regarding the franchise offering, including the franchise agreement and any lease, options, and purchase agreements. This way the State Register can check whether the mandatory documents were provided to the franchisee.

The State Register will only inspect the existence of these documents and the fulfillment of the required information that needs to be provided to the franchisee.

It is important to note that this information is provided to the state register merely to check whether the franchisee had all the required information needed and has negotiated all the essential terms thoroughly studying the agreement and the consequences it generates.

Therefore, only certain information of those provided to the state registry will be available to the public (names, right holders, etc.), and in regards to trade secrets in particular franchise businesses, they will not be included in the disclosure documents (e.g. the operations manual).

This means that businesses that hold confidential information can provide the operations manual to franchisees *after* the signature and registration of the franchise agreement with the State Register.

The following paragraphs will suggest forms necessary to gather the information that needs to be submitted with the State Register regarding the offer and sale of a franchise. It will study and suggest points that need to be taken into consideration when creating the application forms. It

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<sup>43</sup> *NASAA, 2008 Franchise Registration and Disclosure Guidelines (Amended and Restated UFOC Guidelines)*, 8 (2008). Also available at <http://www.nasaa.org/wp-content/uploads/2011/08/6-2008UFOC.pdf>



will then discuss certain exhibits that the franchisor must provide to the franchisee in order for the latter to get familiarized with the franchisor and the franchised business, and analyze the information they must include.

### **Form 1: The Introductory Form**

- I. This form must include the purpose of the application, it should be either an application for the registration of a franchise agreement, or an amendment application. The applicant should choose only one type of filing for each application, as the following:

*APPLICATION FOR (Check only one):*

\_\_\_\_\_ *REGISTRATION OF A FRANCHISE AGREEMENT*

\_\_\_\_\_ *AMENDMENT OF AN EXISTING REGISTERED FRANCHISE AGREEMENT*

This will help the State Register understand how to process the submitted documents and speed the registration process overall.

- II. The introductory form must also contain the filing fee requirement (provided with a receipt from the bank for the full paid amount).  
Registering a franchise will require labor from the government employees checking all the requirements, making it a more or less costly operation that needs remuneration.
- III. It should also include the full legal names of both the franchisor and the franchisee, the name of the franchise system being offered, the principle business address of both the franchisor and the franchisee, and the names, addresses, telephone numbers, and email addresses of the persons to whom the communications regarding this application should be directed to.  
This way the State Register will be able to maintain communications whenever necessary with any party regarding the registration or for any other reason.

- IV. It should include a brief description of the franchised business to familiarize the State Registry with the business.
- V. There should be a section indicating the *Effective Date* of registration, this section will be marked by the State Register after receiving and analyzing the *Receipt Document* and the passage of the 10 day waiting period.
- VI. This form should also contain a certification provided by the franchisor claiming the validity of all the provided documentation alongside the franchise agreement in a statement similar to the following:

*I certify and swear under penalty of law that I have read and know the contents of this application, including the Franchise Agreement with an issuance date of \_\_\_\_\_ attached as an exhibit, and that all material facts stated in the franchise agreement and adjoining documents are accurate and those documents do not contain any material omissions. I further certify that I am duly authorized to make this certification on behalf of the Franchisor and that I do so upon my personal knowledge.*

This should be followed by the signature of the person representing the franchisor, and the title they hold alongside the date of signature.

With this certification the State Register will be able to protect the prospective franchisee from any bad faith dealings on the part of the franchisor in the form of omissions or inaccuracies regarding the provided documents.

## **Form 2: Guarantee of Performance**

The Guarantee of Performance form must be used if the franchisor's parent or affiliate will be guaranteeing the franchisor's performance under the Franchise Agreement.

- I. The guarantor must sign the guarantee, and the date must be provided alongside the signature.

II. The name and title of the guarantor must also be provided in the form.

III. The Guarantee of performance form should have a clause similar to this:

*For value received, [name of guarantor], a [state of formation and form of entity] (the “Guarantor”), located at [address], absolutely and unconditionally guarantees to assume the duties and obligations of [name of Franchisor], located at [address] (the “Franchisor”), under its franchise registration, and under its Franchise Agreement signed on [year]. This guarantee continues until all obligations of the Franchisor under its franchise registrations and the Franchise Agreement are satisfied or until the liability of Franchisor to its franchisee under the Franchise Agreement has been completely discharged, whichever first occurs. The Guarantor is not discharged from liability if a claim by a franchisee against the Franchisor remains outstanding. Notice of acceptance is waived. The Guarantor does not waive receipt of notice of default on the part of the Franchisor. This guarantee is binding on the Guarantor and its successors and assigns.*

*Guarantor:* \_\_\_\_\_

*The Guarantor signs this guarantee at:* \_\_\_\_\_

*By:* \_\_\_\_\_

*Name:* \_\_\_\_\_

*Title:* \_\_\_\_\_

Sometimes the parent or an affiliate of the franchisor will guarantee the franchisor’s obligations, this guarantee plays an important role in the franchise agreement, and thus, having it regulated is of paramount importance.

### **Form 3: Consent of Accountant**

A Consent of the accountant whose audited financial statements of the franchisor must be provided when filing the registration application.

The consent must also be provided to the franchisee 10 days prior to signing the agreement to provide the franchisee with enough time to accurately understand the necessary information regarding the situation of the franchisor and the franchised system.

This form must indicate:

- I. The names of the accountant and the franchisor, to identify them;
- II. The issuance date of the financial statements, to understand whether the audit was newly conducted or not.
- III. The date of the audit report for the audited financial statements and the signature of the accountant.
- IV. A document indicating the Consent of Accountant must also be attached to this application form when applying. This document will be stored with the State Register for future reference when needed.

After filling out the application forms by the franchisor, he or she must attach the Franchise Agreement and any adjoining documents regarding the franchise sale including the mandatory Exhibits in the form provided by the State Register (as proposed by this paper)

These following Exhibits must be provided to the franchisee 10 days prior to signing a franchise agreement, they aim at disclosing the information necessary for the franchisee in making the decision regarding the purchase of the franchise. The franchisor should also attach these Exhibits to the application form when registering with the State Register. The information disclosed to the State Register does not include any confidential information regarding the operation of the business (which we have previously mentioned are provided in the *operations manual*, and that this specific document is not provided to the State Register).

### **Exhibit A: The Acknowledgment Receipt Document**

A statement must be included in the receipt page explaining the purpose of the receipt document as follows:

*This acknowledgment receipt document summarizes certain provisions of the franchise agreement and other information in plain language. Read this document and all agreements and adjoining documents carefully.*

*When a franchisor offers you a franchise, it must provide several documents to you 10 calendar-days before you sign a binding agreement with, or make a payment to, the franchisor or an affiliate in connection with the proposed franchise sale.*

*If the franchisor does not deliver this document on time or if it contains a false or misleading statement, or a material omission, this will violate the law of the Republic of Armenia.*

In this document the franchisor should also:

- i. State the name, principal business address, and telephone number of each franchise seller offering the franchise (franchise brokers). The franchisee might need to discuss the purchase with several brokers before initiating any transactions.
- ii. State the *issuance date*. This way the State Register can ascertain the period in which the franchisor had to disclose the needed information regarding the proposed franchise.
- iii. State the following:

*I \_\_\_\_\_ the prospective franchisee received an acknowledgment of receipt dated \_\_\_\_\_ that included the following Exhibits:*

*A. Franchise Agreement B. The Cover Page C. The Franchised Business D. Litigation history E. Party Obligations F. Exclusive Territory G. Intellectual Property Rights H. Outlets and Franchisee Information I. Financial Statements.*

Signing this receipt document will indicate that the franchisee has received all relevant documents in time, and thus, the State Register will accept the application submitted 10 days after the submitted date of this receipt.

The franchisor must include two copies of the following detachable acknowledgment of receipt in the following form as one of them will be signed and sent back to the franchisor and the other will remain with the franchisee.

### **Exhibit B: The Cover Page**

The registration form must include warning phrases to ensure that the franchisee is not lacking the knowledge of essential information needed to be protected while making the decision to buy a certain franchise system and committing to the obligations opposed by it.

In *Chapter Two*, we have discussed several statements the form must include to protect the franchisee from hidden or “less obvious” risks while entering into the franchise agreement that might be detrimental to the franchised business. In the US, these statements are included in the FDD as a protective tool to prospective franchisees to serve as a warning against deficient clauses.

### **Exhibit C: The Franchised Business**

- I. This document must include information about the franchisor and the franchise being sold in a statement similar to the following:

*The estimated total investment necessary to begin the operation of a \_\_\_\_\_ franchise is \_\_\_\_\_. This includes the initial fees in the amount of \_\_\_\_\_ that must be paid to the franchisor or affiliate. “Initial fees” means all fees and payments, or commitments to pay, for services or goods received from the franchisor or any affiliate before the franchisee’s business opens, whether payable in lump sum or installments.*

This way the prospective franchisee will have a clearer understanding on how much it has to pay before the business starts running. This can also protect the franchisee from unforeseen payments and liabilities on its part.

- II. There must also be a section for the franchisor to fill labeled “franchisor’s other activities”. Here the franchisor will describe any other business (or non-business) activities it conducts to better familiarize the franchisee with the franchisor’s enterprise. When the prospective franchisee is familiarized with the franchisor’s other businesses and activities it will have a better understanding of the type of business partner it will be dealing with after signing the agreement.
  
- III. Another section must be labeled “*General Description of the Competition*”. Here the franchisor must provide a description about any local or international competition to the business in general. Even though the franchisee might do their own research, the information possessed by the franchisor will definitely be of more help in determining the obstacles the business has. The main purpose of the disclosure is to protect the prospective franchisee, and this requirement will be of paramount importance for the prospective franchisee’s final decision to buy a franchise.
  
- IV. The franchisor must disclose by name and position its directors, trustees, general partners, principal officers, and any other individuals who will have management responsibility relating to the sale or operation of franchises.  
  
With this, the prospective franchisee will familiarize itself with all the principal decision makers of the franchise.

### **Exhibit D: Litigation history**

This document will indicate whether the franchisor or a guarantor of the franchisor has pending against them a *criminal, civil, or administrative action*. The franchisee’s knowledge of an action against the franchisor or the guarantor might be one of the most important information in need for disclosure. An action could be detrimental for the entire franchising business and it would be too late to back out once a contract is signed, thus, this disclosure requirement is of paramount importance.

- I. The franchisor must disclose whether it was a party to any material civil action involving the contractual obligations between the franchisor and a franchisee directly relating to the operation of the franchised business (such as royalty payment and training obligations). This way the franchisee can become familiar with possible pitfalls other franchisees fell into when dealing with the franchisor, in order to better avoid such pitfalls.
  
- II. The franchisor must disclose whether it has in the past:
  - i. Been convicted of a felony charge.
  - ii. Been held liable in a civil action involving an alleged violation of a franchise, involving allegations of fraud, unfair or deceptive practices, or comparable allegations.

For each action identified in the previous instructions, the franchisor must state the title, case number or citation, the initial filing date, the names of the parties, the forum, and must disclose the relationship of the opposing party to the franchisor (e.g. franchisee, competitor), the franchisor should also summarize the legal and factual nature of these claims, the relief sought or obtained, and any conclusions reached by the court of law or fact.

These types of charges indicate dishonesty, and when it comes to business transactions, honesty can be considered the cornerstone upon which the entire business relationship is constructed. If the franchisor has been charged with such crimes in the past, the franchisee might be cautious when dealing with that franchisor.

- III. In addition, they must state:
  - i. For pending actions, the status of the action.
  - ii. For prior actions, the date when the judgment was entered and any damages or settlement terms.
  - iii. For injunctive or restrictive orders, the nature, terms, and conditions of the order or decree.



- iv. For convictions or pleas, the crime or violation, the date of conviction, and the sentence or penalty imposed.

In case these cases are numerous, the franchisor may comply with the requirements by listing individual suits under one common heading that will serve as the case summary (for example, “royalty collection suits”).

The purpose of this requirement is to help the franchisee clearly identify each court case and in cases of major franchisors, not be overwhelmed by numerous similar cases with the same outcome.

- IV. The form must also indicate whether the franchisor; any parent; officer, or general partner of the franchisor, has, in the past, filed as a debtor or had filed against it.

The franchisee must be aware of previous bankruptcies the franchisor or an associate went through. Bankruptcies rarely occur due to reasons beyond the directors powers, they are usually the cause of poor management, and the prospective franchisee must be aware of such history to make a better educated decision regarding the purchase.

- V. For each bankruptcy, the franchisor must state:
  - i. The current name, address, and principal place of business of the debtor.
  - ii. Whether the debtor is the franchisor. If not, the relationship of the debtor to the franchisor (for example, affiliate, or officer).
  - iii. The date of the original filing and the material facts including the case name and number.

This requirement aims at identifying the debtor and its relationship to the franchisor, the prospective franchisee might need to contact the debtor to better understand the situation the franchisor was in and the reasons that led to the bankruptcy.

- VI. The franchisor must also disclose cases, actions, and other proceedings under the laws of foreign nations relating to bankruptcy.

In the case of international franchising, the franchisor is a foreign entity conducting business in several countries. It might be just as necessary for the franchisee to be informed about such bankruptcies as the ones that occur on the territory of the Republic of Armenia for the same mentioned reasons.

## **Exhibit E: Party Obligations**

### **I. Franchisee's Obligations:**

#### **i. Restrictions on Sources of Products and Services.**

This document must be provided to the franchisee if the franchisor has any restrictions on the sources of products and services.

Whether the franchisee has an obligation to purchase or lease goods, services, supplies, fixtures, equipment, inventory, computer hardware and software, real estate, or comparable items related to establishing or operating the franchised business either from the franchisor, its designee, or suppliers approved by the franchisor, or under the franchisor's specifications.

The franchisee must be aware of this requirement prior to signing any agreement. Sometimes franchisors may require purchasing from a single source, this can raise problems if the franchisee is located in a country where supplying from this single source is overburdening and impractical, thus, knowledge of such requirement is essential to protect franchisees.

For each applicable obligation, the franchisor must state:

- The good or service required to be purchased or leased.
- Any supplier in which an officer or a director of the franchisor owns an interest.
- If a designated supplier will make payments to the franchisor from franchisee purchases, state the basis for the payment (for example, specify a percentage or a flat amount).

When the state requires such information be disclosed, the franchisee will become aware of the payments made to the franchisor. This will protect the franchisee against possible deception.

If the franchisor or its affiliates will or may derive revenue or other material consideration from required purchases or leases by franchisees, the franchisor must describe the precise basis by which the franchisor or its affiliates will or may derive that consideration by stating the franchisor's total revenue, for reasons similar to those mentioned in the earlier paragraph.

ii.      Obligation to Participate in the Actual Operation of the Franchise Business.

In this section the franchisor must disclose the franchisee's obligation to participate personally in the direct operation of the franchisee's business and whether the franchisor recommends participation.

Also state whether the franchisee should place any restrictions on its manager (for example, maintain trade secrets, covenants not to compete).

These requirements might be necessary when the franchisor requires active participation of the franchisee in management of the franchise location, here the franchisee must be aware of the obligations it personally must be involved with.

iii.      Restrictions on What the Franchisee May Sell.

The franchisor must disclose any franchisor-imposed restrictions or conditions on the goods or services that the franchisee may sell or that limit access to customers, including:

- Any obligation on the franchisee to sell only goods or services approved by the franchisor.
- Any obligation on the franchisee to sell all goods or services authorized by the franchisor.

- Whether the franchisor has the right to change the types of authorized goods or services and whether there are limits on the franchisor's right to make changes.

The franchisor might decide to protect the reputation of their brand by maintaining control over what the franchisee may or may not sell. The franchisee must be aware of such requirement prior to signing an agreement to avoid certain unforeseen losses.

iv. Advertising.

In a different section of the exhibit the franchisor must state whether the franchisee must participate in a local or regional advertising cooperative, as well as in any other advertising fund.

The prospective franchisee must be aware of these expenses prior to signing any agreement to better understand its expenses prior to starting the business.

II. Franchisor's Obligations:

In this section the franchisor should state and explain whether it has pre-opening obligations and then whether it has any obligations during the operation of the franchise. These can take the form of staff training, consultations, or any other obligations.

### **Exhibit F: Exclusive Territory**

I. If the franchisor does not grant an exclusive territory, it must state:

*"You will not receive an exclusive territory. You may face competition from other franchisees, from outlets that we own, or from other channels of distribution or competitive brands that we control."*

The purpose of such statement is to make sure that the franchisee knows that they may face competition from other local franchisees within the same franchise, competition can also come from branches the franchisor may decide to operate within the same territory. The

franchisee must take these considerations into account when there is no exclusive territory granted.

- II. If the franchisor grants an exclusive territory, it must disclose:
  - i. Whether continuation of territorial exclusivity depends on achieving a certain sales volume, market penetration, or other contingency, and the circumstances by which the franchisee's territory may be altered. The franchisor's rights should also be identified if the franchisee fails to meet the requirements.
  - ii. Any other circumstances that permit the franchisor to modify the franchisee's territorial rights (for example, a population increase in the territory giving the franchisor the right to grant an additional franchise in the area) and the effect of such modifications on the franchisee's rights.
  - iii. Whether there are any restrictions on the franchisee from soliciting or accepting orders from consumers outside of its territory, including whether the franchisee has the right to use other channels of distribution, such as the Internet, catalog sales, telemarketing, or other direct marketing, to make sales outside of its territory.

When an exclusive territory is given to a franchisee by what is called a *Master Franchise*, the rights of the master franchisee to hold such title must be clear and identified by the parties, the restrictions on the master franchisee should also be stated in the exhibit to avoid future conflicts between the parties.

- III. If the franchisor or an affiliate operates, franchises, or has plans to operate or franchise a business under a different trademark and that business sells or will sell goods or services similar to those the franchisee will offer, describe:
  - i. The similar goods and services.
  - ii. The different trademark.
  - iii. Whether outlets will be franchisor owned or operated.
  - iv. Whether the franchisor or its franchisees who use the different trademark will solicit or accept orders within the franchisee's territory.

- v. The timetable for the plan.
- vi. The principal business address of the franchisor’s similar operating business. If it is the same as the franchisor’s principal business address stated in *Form 1*, disclose whether the franchisor maintains (or plans to maintain) physically separate offices and training facilities for the similar competing business.

These requirements reveal the franchisor’s plans when operating a similar competitive business, and allow the franchisor elaborate on how it plans to separate the operation and management of the two businesses.

### **Exhibit G: Intellectual Property Rights**

- I. In regards to trademarks, the franchisor must disclose:
  - i. Each *principal trademark* to be licensed to the franchisee. For this Item, “principal trademark” means the primary trademarks, service marks, names, logos, and commercial symbols the franchisee will use to identify the franchised business. It may not include every trademark the franchisor owns.

The franchisor must clearly state what is being licensed to avoid any disputes caused by misunderstandings when operating the business.

- ii. Whether each principal trademark is registered with the Intellectual Property Agency of the Republic of Armenia.

If the *principal trademark* is not registered with the Intellectual Property Agency of the Republic of Armenia, the franchisor must state whether it filed any trademark applications. If so, also state the date and identification number of the application.

This obliges the franchisor who claims filing a trademark application to also provide the franchisee with the identification number of the application.

- iii. If the trademark is *not registered* with the IPA or it is not protected under other international instruments, the franchisor must state: “*We do not have a*

*registration for our principal trademark. Therefore, our trademark does not have many legal benefits and rights as a registered trademark. If our right to use the trademark is challenged, you may have to change to an alternative trademark, which may increase your expenses.”*

iv. Any pending *material* court litigation regarding the franchisor’s use or ownership rights in a trademark. For each pending action, disclose:

- The forum and case number.
- The nature of claims made opposing the franchisor’s use of the trademark or by the franchisor opposing another person’s use of the trademark.
- Any effective court or administrative agency ruling in the matter.

The franchisee must become aware of any pending material litigation regarding the franchise trademark, with such information the prospective franchise would probably consider postponement of purchasing the franchise until there is a court ruling.

v. Any *currently effective agreements* that significantly *limit* the franchisor’s rights to use or license the use of trademarks listed in this section in a manner material to the franchise. For each agreement, disclose:

- The manner and extent of the limitation or grant.
- The extent to which the agreement may affect the franchisee.
- The agreement’s duration.
- The parties to the agreement.
- The circumstances when the agreement may be canceled or modified.
- All other material terms that may be of significance for the franchisee.

vi. Whether the franchisor must protect the franchisee’s right to use the principal trademarks listed in this section, and must protect the franchisee against claims

of infringement or unfair competition arising out of the franchisee's use of the trademarks.

- vii. The franchisee's rights under the franchise agreement if the franchisor requires the franchisee to *modify or discontinue* using a trademark. This requirement is of paramount importance where the franchisee's use of the trademark would be materially limited and the benefits provided by the trademark would vanish, thus the franchisee is provided an opportunity to plan in advance for such a hypothetical situation.
  
- viii. Whether the franchise agreement requires the franchisor to participate in the franchisee's defense and/or indemnify the franchisee for expenses or damages if the franchisee is a party to an administrative or judicial proceeding involving a trademark licensed by the franchisor to the franchisee, or if the proceeding is resolved unfavorably to the franchisee.
  
- ix. Whether the franchisor knows of either superior prior rights or infringing uses that could materially affect the franchisee's use of the principal trademarks in the Republic of Armenia. For each use of a principal trademark that the franchisor believes is an infringement that could materially affect the franchisee's use of a trademark, disclose:
  - The nature of the infringement.
  - The locations where the infringement is occurring.
  - The length of time of the infringement (to the extent known).
  - Any action taken or anticipated by the franchisor.

Disclosing such information to prospective franchisees can go against the franchisor's interests, therefore, making these disclosures a requirement is essential for the promotion of fair business practices.



- II. In regards to Patents, Copyrights, and Proprietary Information, the franchisor must disclose:
- i. Whether the franchisor owns rights in, or licenses to, patents or copyrights that are material to the franchise.
  - ii. Whether the franchisor has any pending patent applications that are material to the franchise. If so, state:
    - a. The nature of the patent, patent application, or copyright and its relationship to the franchise.
    - b. For each patent:
      - The duration of the patent.
      - The type of patent (e.g. mechanical).
      - The patent number, issuance date, and title.
    - c. For each patent application:
      - The type of patent application.
      - The serial number, filing date, and title.
    - d. For each copyright:
      - The duration of the copyright.
      - The registration number and date.
      - Whether the franchisor can and intends to renew the copyright.
  - iii. The forum, case number, claims asserted, issues involved, and effective determinations for any material proceeding pending in any court.
  - iv. If an agreement limits the use of the patent, patent application, or copyright, state the parties to and duration of the agreement, the extent to which the agreement may affect the franchisee, and other material terms of the agreement.

- v. The franchisor’s obligation to protect the patent, patent application, or copyright; and to defend the franchisee against claims arising from the franchisee’s use of patented or copyrighted items.
- vi. If the franchisor knows of any patent or copyright infringement that could materially affect the franchisee, disclose:
  - The nature of the infringement.
  - The locations where the infringement is occurring.
  - The length of time of the infringement (to the extent known).
  - Any action taken or anticipated by the franchisor.

The nature of franchising revolves around ownership and usage of *Intellectual Property Rights*, thus having the most essential elements in this sphere regulated is of paramount importance to ensure the sustainability, and the promotion of successful business environment in the Republic of Armenia.

## **Exhibit H: Outlets and Franchisee Information**

The franchisor must disclose:

- I. The total number of franchised and company-owned outlets for each of the franchisor’s last three fiscal years. The term “outlet” here includes outlets of a type substantially similar to that offered to the prospective franchisee.  
  
With this requirement, the prospective franchisee will have a better understanding of the franchisor’s growth rate and make a better educated estimate regarding the future of the franchise.
- II. The names of all current franchisees in the Republic of Armenia and the address and contact information of each of their outlets. The prospective franchisee might need to ask these franchisees about their experience within the franchise system. While some

franchisors might provide this information without hesitation, others might not do so, therefore, requiring them to disclose this information is necessary.

The franchisor should also notify the prospective franchisee that if they decide to buy the franchise, their contact information might be disclosed to other prospective franchisees in the future.

- III. Whether the other franchisees signed confidentiality clauses. If so, the following must be stated: *“In some instances, current and former franchisees sign provisions restricting their ability to speak openly about their experience with [name of franchise system]. You may wish to speak with current and former franchisees, but be aware that not all such franchisees will be able to communicate with you.”* Franchisors may also disclose the number of current and former franchisees who signed agreements that include confidentiality clauses.

### **Exhibit I: Financial Statements**

These financial statements must be audited by an independent certified public accountant using generally accepted GA auditing standards. Present the franchisor’s balance sheet in a tabular form that compares at least the two previous fiscal years.

## **CONCLUSION**

Franchising has been a prominent method for business expansion both locally and internationally. It benefits the franchisor by expanding its business without investing in capital, and also the franchisee who enjoys the use of well-known brands and other intellectual property.

The nature of franchise agreements make it a necessity for businesses that require strict quality control provisions for its services or products to either maintain the value of a brand or insure the success of their business.

Franchise contracts are complicated and vary depending on the franchisor. The more prominent a franchise is, the more influence the franchisor will have and the less negotiable the contract will be. This can lead to situations where franchisees sign contracts without having the power to negotiate and ask for the disclosure of certain information regarding the operations and financial history of the franchisor. Thus, this transaction must be regulated by the state to make sure all information a prospective franchisee might need for the franchise purchase is provided before making any payment and signing the franchise agreement.

Some countries do not have a franchise law, instead the franchise transactions are regulated by other sectors of the law (e.g. contract law). In Armenia the Civil Code specifies a section to regulate franchise transactions.

In Article 970 (2) of the Civil Code of the RA, the legislator requires the registration of the franchise agreement with the State Register prior to conducting the transaction, and without such registration Article 302 (1) renders such an agreement void.

However, in practice, there is no registration procedure to comply with. Thus, this paper aims at suggesting content to be included when creating registration forms by including certain disclosure requirements on the franchisors in *Exhibits* containing specific information provided to the franchisees to protect them and the business environment overall.

The forms have been created based on the long and rich history of the US practice in franchising by taking into consideration the NASAA 2008 Franchise Registration and Disclosure Guidelines which are still being used today.

These requirements will help both franchisors and franchisees avoid pitfalls caused by lack of negotiations or disclosures in some areas, and will limit misunderstandings by requiring clarifications in others.

The adoption of these requirements and the principles they uphold will help the Armenian market create the infrastructure for the many franchise agreements operating without legal basis today, while providing a legal structure for contemplating businesses for further expansion in Armenia.

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