

FRANCHISES

Overview

Franchising offers the opportunity to secure distribution for products and services faster than would otherwise be the case. The franchisor may be able to increase purchasing power and reduce overheads. The disadvantage of franchising is loss of control. Although a franchise agreement may impose restrictions, the franchisees are independent third parties who maximise profits on their own account.

The franchisee operates his business under the franchisor's trade name so that it appears to the outside world, to be the franchisor. The franchisor would expect to have significant influence and control over the way the franchisee operates its business.

There are a number of methods of setting up franchises overseas. The franchisor might grant franchises directly to a franchisee in the target country. A joint venture might be set up between the franchisor and a resident of the target company.

A Franchise Agreement will typically be set up where an existing successful business wishes to expand and an existing business with little or no experience of the proposed area decides to enter the business area. A Franchise Arrangement will typically commence with a pilot operation. This is necessary to enable the franchisee to appraise the feasibility of the project.

Franchise Agreement

A franchise is an agreement or arrangement to conduct a particular business in accordance with an established format, brand, technique, format or model. In return, the franchisee usually pays a fee and a percentage of the sales revenue to the franchisor.

Examples of franchises would include MacDonalds, O'Briens Irish Sandwich Bars, Prontoprint, Dynorod and Coffee Republic.

The franchisor allows the franchisee to use a name and business methods associated with the franchisor. The franchisor can exercise its continuing control over the franchisee. The franchisor provides assistance and the franchisee makes payments in return.

Under a franchise agreement, the franchisor sells his products and services to the franchisee. The franchisee trades under the franchisor's trade marks and trade names and benefits from the franchisor's help and support. Franchise agreements will typically provide rights for a particular term and a particular territory. .

The franchisor will keep control of how the franchise brands and trade marks are marketed and used. There will usually be an upfront fee payable to the franchisor to enter the franchise agreement. A franchisee's business is an independent business entity, which will have all the usual obligations such as registration for tax, VAT etc.

There will usually be a requirement to pay a percentage of sales and/or a management fee to the franchisor. The franchisee will typically have to buy stock or product from the franchisors. It may also be necessary to purchase training and contribute to the costs of any advertising campaigns. There may also be competition law issues which need to be considered.

Advertising and promotion is an important element in franchising. The franchisor's brand, products and services are advertised and the franchise agreement requires the franchisee to pay an advertising levy to enable advertising to be undertaken.

Intellectual property rights will typically be included as part of the franchising package. The franchisor will typically have built up substantial know how and brands. Copyright may exist for advertising slogans. Trademarks and unregistered designs are usually significant. Franchisors usually require franchisees to enter into a Licence Agreement in relation to use of the licensed trademarks.

Franchising is not directly regulated in the United Kingdom. The Franchise Association requires its members to comply with certain codes of ethics for franchising. There is legislation restricting certain trading and pyramid schemes.

Structure of Franchising

The franchisor may grant a master franchise agreement. This master franchisor is given the exclusive right to operate and grant franchises within the territory. It undertakes to appoint a franchisee on the basis of franchise agreements stipulated by the franchisor.

An Operations Manual typically operates in conjunction with the franchise contract and regulates the terms under which the franchisee operates the business. It will set out the day to day operational instructions.

It is not unusual for the franchisor to take a lease of premises and grant a sub-licence to the franchisee in order to satisfy landlord's requirements. The franchisor might alternatively grant a licence to occupy premises to the franchisee.

Some distributorships have elements of a franchise. For example, motor vehicles distribution agreement may be undertaken under the franchisor's name. There tends to be more freedom with distributorships than with a pure franchise arrangement.

Competition Law Issues

UK competition laws are broadly favourable to franchising. Although some clauses in franchise agreements could breach the Competition Act, a number of exceptions are potentially available.

A franchise agreement with a combined turnover with less than £20M is not subject to regulatory control. Third parties could take action in relation to such agreements but this is unlikely.

The notice on minor agreements may apply. Minor agreements are those relating to less than 10% of market for horizontal agreements and less than 15% for vertical agreements.

UK competition law prohibits abuse of a dominant position. Abuse would generally include discriminatory pricing, predatory pricing or refusal to supply without justification. In practice, few franchisors would have a dominant position.

The European Commission has made it clear that competition concerns only arise in relation to franchise agreements, if there is insufficient inter-brand competition. The European Union Vertical Agreement Block Exemption may be relevant.

This Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances.

This Guide should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances.

While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in this Guide. The reader should rely only on specific legal or taxation advice.