

GETTING THE DEAL THROUGH®

Franchise

in 33 jurisdictions worldwide

Contributing editor: Philip F Zeidman

2009



Published by

GETTING THE DEAL THROUGH
in association with:

Advokatfirmaet Storløkken AS

Akademia Rozwoju Systemów Sieciowych Sp z oo

Allen & Overy LLP

Al Sarraf & Al Ruwayeh

Anderson Mo-ri & Tomotsune

Angara Abello Concepcion Regala & Cruz Law Offices
(ACCRALAW)

Attorneys-at-Law Juridia Ltd

Bahas, Gramatidis & Partners

Bersay & Associés

Bowman Gilfillan Inc

DLA Piper UK LLP

DLA Piper US LLP

Duro & Lorang

Gateway Law Corporation

Gonzalez Calvillo SC

Kanga & Co

Koan Legal Strategies

Lapointe Rosenstein LLP

Lee & Ko

Longan Law Firm

Makarim & Taira S

Mason Sier Turnbull

Mboya & Wangong'u Advocates

McConnell Valdés LLC

Nörr Stiefenhofer Lutz

Nörr Stiefenhofer Lutz OOO

Palacios & Asociados

Raffalli de Lemos Halvorssen Ortega y Ortiz

Rödl & Partner

Stewart Germann Law Office

Thylin Advokatbyrå AB

Tov Noerr Stiefenhofer Lutz

Wong Jin Nee & Teo

United Kingdom

Peter Brook

DLA Piper UK LLP

Overview

- 1 What forms of business entities exist that would be relevant to the typical franchisor?

In England and Wales, a typical franchisor may operate as a sole trader (an individual trading alone without any separate legal entity), a partnership, a company (the most common for franchisors being public limited companies (PLCs) or companies limited by shares) or limited liability partnerships (LLPs). PLCs can either be listed on a recognised stock exchange or not, but they are generally used by large national franchisors. More commonly, franchisors that establish a company (at least initially) would establish a private company limited by shares. It is private companies that we have concentrated on. Franchisors may also consider setting up a joint venture with an existing business in a target country with knowledge of the market in that country.

Please note that the Scottish legal system differs in some ways from that of England and Wales. The information set out in this chapter is given from the perspective of the laws of England and Wales.

- 2 What laws and agencies govern the formation of business entities?

The Companies Acts 1985, 1989 and 2006 govern companies; the Limited Liability Partnerships Act 2000 governs LLPs; and the Partnership Act 1890 governs partnerships. The common law on partnership also applies to partnerships.

All companies and LLPs incorporated in the UK are registered at Companies House, an executive agency of the Department for Business, Enterprise and Regulatory Reform. The chief executive of Companies House is the registrar of companies for England and Wales.

- 3 Provide an overview of the requirements for forming and maintaining a business entity.

There are no specific requirements for an individual to set up and maintain a business as a sole trader, apart from the requirement to pay income tax on any profits.

A partnership is defined in section 1(1) of the Partnership Act 1890 as 'a relation between persons carrying on business with a view to profit'. Partnerships are usually documented by way of a partnership agreement, but this is not necessary for a legal partnership to arise. The terms of any partnership agreement will govern the ongoing relationship of the partners. In the absence of a partnership agreement, the Partnership Act 1890 implies various terms, for example: profits and losses are to be shared equally in the absence of a contrary indication and a unanimous decision is needed to change the nature of the partnership business.

The formation and ongoing requirements of companies and LLPs are governed by the Companies Acts and the Limited Liability Partnerships Act 2000 respectively.

To incorporate a private company there must be at least one director and one secretary (the same person cannot perform both roles) and at least one initial subscriber to the share capital of the company. These individuals must indicate their willingness to act in such capacity to the registrar of companies. The rules in relation to public companies differ slightly. The company must also provide a registered address from which it will trade. The secretary is responsible for maintaining an up-to-date set of statutory books containing, among other things, a register of all shareholders in the company and details of the officers of the company and their interests. The company must also submit an annual return and file accounts with the registrar. All of this information is publicly available. For further details refer to the website: www.companieshouse.gov.uk.

To incorporate an LLP, two or more persons that are associated for the carrying on of a lawful business with a view to profit must subscribe their names to an incorporation document. This document must be sent to the registrar together with a statement in the required form confirming that the requirements of the Limited Liability Partnerships Act 2000 have been fulfilled. Ongoing requirements for LLPs are substantially the same as for companies.

The Companies Acts require companies and LLPs to display their company registration number and the registered office on all letters and order forms. It is not necessary to state the directors' names on letters but if the company chooses to do so, it must state the names of all its directors. The Business Names Act 1985 requires partnerships to have the names of all partners on business letters and order forms and requires a sole trader to display his or her name on these documents. It also requires, in each case, an address in Great Britain at which service of any document relating in any way to the business will be effective. Both these pieces of information must be displayed at any premises where the business is carried out and to which customers and suppliers may have access.

Any business that employs staff is legally required to have employers' liability insurance to provide cover against claims made by employees for injuries or illness suffered as a result of their work.

- 4 What restrictions apply to foreign business entities and foreign investment?

The UK is an open economy. No general restrictions are imposed on foreign ownership or investment in the UK and there are no general restrictions on the foreign ownership of local enterprises. Neither are there requirements for UK participation in a foreign-owned enterprise. UK Trade and Investment is the government organisation that supports overseas enterprises seeking to invest or locate in the UK. Their website details are www.ukinvest.gov.uk/index.html.

Under EU law, national laws should not discriminate between domestic and foreign-owned businesses. European franchisors

should not therefore encounter restrictions on setting up branches or subsidiaries in the UK.

There are, however, certain ancillary pieces of legislation that may have an impact on a foreign franchisor. For example, under the Data Protection Act 1998, a data controller must be based in either the UK or the EU.

The tax and accounting treatment of foreign business entities and investment should always be considered carefully as the rules may differ for foreign business entities. Further, money-laundering regulation may place an administrative burden on a foreign company wanting to open a bank account in the UK.

5 Briefly describe the aspects of the tax system relevant to franchisors. How are foreign businesses and individuals taxed?

In the UK, there are no specific tax law provisions that relate specifically to franchising. Therefore, tax treatment will be considered in accordance with normal tax rules. Sole traders are liable to pay income tax on any profits they make through their business. Partnerships are tax-transparent in that partners are taxed individually, that is, they are liable to pay income tax on their share of the partnership profits. Companies will be subject to corporation tax and must submit a corporation tax return together with a set of accounts to HM Revenue & Customs (HMRC) (www.hmrc.gov.uk) on an annual basis. Failure to file the corporation tax return correctly or failure to pay the corporation tax due on time may result in financial penalties.

PAYE (pay as you earn) is the HMRC system for collecting income tax from the pay of employees as they earn it. If the franchisor employs staff then it will need to deduct income tax under the PAYE system and National Insurance contributions from its employees' pay and submit the deductions to HMRC.

Should a franchisor sell the business, capital gains tax will usually be payable. A capital gain arises when certain assets are sold at a profit. The gain is the sale proceeds (net of selling costs) less the purchase price (including acquisition costs).

In general, foreign businesses, whether a corporate entity or an individual, will not be taxable in the UK unless they have a 'permanent establishment' here, for example, a branch or a subsidiary. If the foreign entity has a permanent establishment in the UK, it is likely to be charged UK tax on its profits, that is, the franchise fees. If there is no permanent establishment in the UK, that is, the franchise fees are paid directly to an overseas based business, the fees may be subject to UK withholding tax, which would be deducted by the franchisee. The rate of withholding tax will depend on whether there is a double tax treaty between the UK and the country where the franchisor is resident. Such treaties will often reduce the withholding tax rate to nil, but they must be checked carefully.

Depending on the value of sales made by a franchisor then it may also be required to register for UK value added tax.

6 Are there any relevant labour and employment considerations for typical franchisors? What is the risk that a franchisee or employees of a franchisee could be deemed employees of the franchisor? What can be done to reduce this risk?

Franchisors will typically have limited numbers of staff. It is franchisees which will normally employ large numbers of staff. It is important, however, that franchisors have regard to the following.

UK law outlaws discrimination in employment on various grounds including sex, race, disability, age, sexual orientation and religion. It also outlaws instructions to discriminate. Therefore, if franchisors retain a right to require a franchisee to ensure a particular individual should not work in the franchise, they need to ensure that they can demonstrate a good and lawful reason for relying on that

right. The same would apply if franchisors insist on matters such as minimum educational or experience standards for employees, or particular uniforms or dress codes. All of this anti-discrimination legislation would also apply to a UK-based franchisor that directly employs its own staff.

Reputational issues for the franchisor may arise from poor employment practices. Franchisors may therefore require contractual assurances from their franchisees that they will operate as reasonable employers and comply with employment legislation.

If a franchise agreement is terminated and, following termination, either the franchisor takes on the conduct of the business or another franchisee steps into the shoes of the original franchisee, then it is very likely that there will be a relevant transfer for the purposes of the Transfer of Undertakings (Protection of Employment) Regulations 2006. In essence, this means that the employees of the original franchisee will be entitled to continue in employment with the business under the new ownership on the same terms and conditions that they had immediately before termination of the original franchise. It may therefore be prudent to include a provision in the franchise agreement that will protect the franchisor in this eventuality.

Where there is a contract of employment in place between a franchisee and its employees then it is very unlikely that the employees would be deemed to be employees of the franchisor. To reduce this risk there should be no instructions given to or orders placed with the employees by the franchisor. The franchisor may wish to include a warranty from the franchisee that a signed contract of employment will be entered into with all employees before the employees commence work and an indemnity from the franchisee in respect of any claims against the franchisor by the employees.

7 How are trademarks and know-how protected?

Trademarks are protected by registration under the Trade Marks Act 1994. Registration of the trademark protects the use of the mark in relation to a specific class of goods or services.

The owner of an unregistered trademark can seek to rely on the tort of passing off to assert its rights if it has sufficient trading goodwill in the mark, the other party has made a misrepresentation about its goods and services and damage has been, or is likely to be, caused to its goodwill.

Know-how is usually protected by way of confidentiality provisions in the franchise agreement (see question 31 for further information).

8 What are the relevant aspects of the real estate market and real estate law?

It is possible to hold land either by way of 'freehold' or 'leasehold'.

In a situation where the franchisee is not of sufficient financial standing to satisfy a landlord's requirements, the franchisor may have to enter into the lease instead. If this is required then franchisors should note:

- the lease will need to allow the franchisor to grant an underlease or licence to the franchisee;
- termination of the franchise agreement may therefore need to coincide with the termination provisions under the underlease to ensure that the franchisor can give vacant possession of the head lease at the expiry of the term;
- the underlease should be excluded from the security of tenure provisions contained in the Landlord and Tenant Act 1954 to ensure vacant possession can be obtained; and
- the terms of the underlease should reflect the terms of the head lease and the franchise agreement may need to take the head lease terms into account.

In some instances, the landlord may require a third party to guarantee the tenant's performance of its obligations under the lease. Again, this will depend on the perceived financial standing of the party entering the lease.

The term of the franchise agreement should be considered in conjunction with the term of lease available on any particular site. For example, a relatively short initial term may be proposed for the franchise agreement (for example, a year), but it may not be possible for the franchisee to obtain a lease in a prime location for such a short term.

If the franchise agreement contains an option to renew by either party then this will need to be reflected within the lease. If the lease is excluded from the Landlord and Tenant Act 1954, the franchisee will not have a right to renew the lease at the expiry of the term – this will be at the discretion of the landlord. The franchisee could therefore be in a position where it can renew the franchise agreement but not continue to occupy the property.

It is unlikely that a franchisee would wish to acquire a freehold interest in property from the outset, as this would require a substantial capital investment before the success of the franchise has been proven.

If premises have not been identified when the franchise agreement is negotiated, franchisors should consider whether the agreement is conditional upon the franchisee identifying suitable premises that are approved by the franchisor. Similarly, if planning approval will be required in order to fit out the proposed premises, then the grant of the franchise should be conditional on such approval being obtained.

LAWS AND AGENCIES THAT REGULATE THE OFFER AND SALE OF FRANCHISES

9 What is the legal definition of a franchise?

There is no legal definition of franchise in the UK, but the British Franchise Association (BFA) has produced the following as a guideline: 'Business format franchising is the granting of a licence by one person (the franchisor) to another (the franchisee), which entitles the franchisee to trade under the trade mark or trade name of the franchisor and to make use of an entire package, comprising all the elements necessary to establish a previously untrained person in the business and to run it with continual assistance on a predetermined basis.'

The BFA is an association that acts in the interests of the franchise industry in the UK. See www.british-franchise.org.

10 Which laws and government agencies regulate the offer and sale of franchises?

The offer and sale of franchises in the UK is self-regulated. But the UK laws on trading schemes, which are aimed at the practice of pyramid selling, could have an impact on franchisors wishing to set up a master franchise system.

The Office of Fair Trading (OFT) enforces EC Competition law and reviews proposed mergers in the UK, and therefore if the franchisor has a material market share in the UK it may have to provide information on the proposed sale of franchises to the OFT to obtain authorisation.

11 Describe the relevant requirements of these laws and agencies.

If a franchise system is held to be a trading scheme under the Fair Trading Act 1973 (sections 118–123) and the Trading Schemes Act 1996, it must comply with a series of regulations containing restrictions that substantially affect the franchisor's ability to act freely. For example, the franchisor will be subject to stringent advertising restrictions, agreements must contain specified information and new franchisees will be entitled to a 14-day 'cooling-off' period before they are legally bound by any agreement entered into.

See questions 34 and 35 for further information on UK competition laws.

12 What are the exemptions and exclusions from any franchise laws and regulations?

Single-tier trading schemes under which all UK franchisees operate at a single level except for the franchisor (direct franchising) and agreements where all the franchisees are registered for VAT are exempted from the trading scheme legislation.

See questions 34 and 35 for further information on UK competition laws.

13 In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the sub-franchisor?

There is no specific requirement for pre-sale disclosures to be made in a sub-franchising arrangement. The Trading Schemes Act 1996 may apply, however, which imposes various restrictions on the potential master franchisor (see question 11). Further, the European Franchise Federation's European Code of Ethics for franchising (as to which see question 19) provides that certain disclosures must be made to any prospective individual franchisee.

14 What is the compliance procedure for making pre-contractual disclosure in your country? How often must the disclosures be updated?

Not applicable – see question 13.

15 What information must the disclosure document contain?

Not applicable – see question 13.

16 How do the relevant government agencies enforce the disclosure requirements?

Not applicable – see question 13.

17 What actions can franchisees take to obtain relief for violations of disclosure requirements? What are the legal remedies for such violations? How are damages calculated? If the franchisee can cancel or rescind the franchise contract, is the franchisee also entitled to reimbursement or damages?

Not applicable – see question 13.

18 In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

Not applicable – see question 13.

19 In addition to any laws or government agencies that specifically regulate offering and selling franchises, what are the general principles of law that affect the offer and sale of franchises? What other regulations or government agencies or industry codes of conduct may affect the offer and sale of franchises?

The BFA requires its members to comply with its Code of Ethics (the Code), which is substantially based on the European Code of Ethics

for Franchising. The Code requires franchisors to have undertaken a trial operation of the business before launching the franchise, to prove ownership of all intellectual property associated with the franchise and to provide initial and ongoing training to the franchisee. Membership of the BFA is voluntary and therefore franchisors who are not members do not have to comply with the Code's requirements.

Generally, the offering and selling of franchises is governed by contract law and the lawyers involved for franchisor or franchisee or for the buying franchisee or selling franchisee will generally negotiate (to varying degrees) the terms of offer or sale.

20 What other actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises? How does this protection differ from the protection provided under the franchise sales disclosure laws?

If a franchisor engages in fraudulent or deceptive practices, the franchisee may have a remedy for fraudulent misrepresentation. To bring an action, the franchisee must prove, on the balance of probabilities, that the franchisor made a false statement, which he or she knew or believed to be false at the time it was made, and that the franchisee was induced into entering the agreement by it, thereby suffering loss. If the franchisee is successful in proving this, then the franchisee will be able to treat the contract as if it had never existed and potentially claim damages. Franchisors can protect themselves to a certain degree by ensuring that properly drafted 'entire agreement' and 'no representation' clauses are included in the franchise agreement.

Legal restrictions on the terms of franchise contracts and the relationship between parties involved in a franchise relationship

21 Are there specific laws regulating the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

There are no specific laws regulating the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect. General principles of contract law will apply.

22 Do other laws affect the franchise relationship?

Under the Data Protection Act 1998, anyone processing personal information must comply with eight principles of good information handling. The eight principles state that the data must be:

- fairly and lawfully processed;
- processed for limited purposes;
- adequate, relevant and not excessive;
- accurate and up to date;
- not kept longer than necessary;
- processed in accordance with the individual's rights;
- secure; and
- not transferred to countries outside the European Economic Area, unless there is adequate protection.

The Unfair Contract Terms Act 1977 (UCTA) imposes limits on the ability of the franchisor to exclude or limit its liability through the use of exclusion clauses. It is not possible to cap or exclude liability for death or personal injury caused by negligence, or for fraud.

Franchise agreements are generally classed as standard terms of business and as such any other exclusion clauses included will only be valid if they are fair and reasonable.

Other laws such as the Consumer Protection Act 1987, the Sale of Goods Act 1979 (as amended) and the Supply of Goods and Services Act 1982 (as amended) imply certain terms into contracts, most importantly in relation to the quality and suitability of the goods sold

or services provided. For further information on competition law, please see question 34.

The Consumer Protection from Unfair Trading Regulations 2008 impose obligations on 'traders' (under which definition franchisees could fall) in relation to the commercial practices they engage in with consumers. The Regulations set out 31 commercial practices which are automatically deemed to be unfair and are prohibited in all circumstances. In addition, a number of other commercial practices could be prohibited depending on their effect on the 'average consumer'. The Regulations also impose a general duty of 'professional diligence' on traders in their dealings with consumers. Commercial practices covered by the Regulations range from advertising and point of sale techniques to debt collection processes.

23 Do other government or trade association policies affect the franchise relationship?

See information on the Code of Ethics in question 19. This also imposes ongoing obligations on the franchisor and franchisee to deal fairly with one another, and specifically on the franchisor in relation to recruitment, advertising and the terms of the franchise agreement.

24 In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

A franchise agreement will typically contain terms allowing the franchisor to terminate for the franchisee's insolvency or its material breach of the agreement.

UK law imposes no specific provisions relating to the termination of franchise agreements.

General common law principles would allow either party to terminate by virtue of a fundamental breach of contract by the other party, (a breach so serious that it appears the other party no longer wishes to be bound by the contract).

25 In what circumstances may a franchisee terminate a franchise relationship?

Subject to the termination rights it may have under the franchise agreement, the same common law principles stated above will apply to the franchisee.

26 May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

Subject to any specific renewal provisions in the franchise agreement, there is no general legal obligation on a franchisor to renew. However, franchisees are usually given the right to renew for at least one further period, generally the same length as the first. Renewal is not usually granted unless the franchisee has performed adequately. The right to renew can be made conditional upon, for example, the re-entering into of the current form of agreement, completion of refresher training or payment of legal costs.

27 May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

A franchisor may restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity. The franchise agreement usually stipulates that the franchisee has no right to transfer the franchise without the franchisor's consent.

28 Are there laws or regulations affecting the nature, amount or payment of fees?

There are no laws or regulations affecting the nature, amount or payment of fees, except that taxation and competition legislation will apply.

29 Are there restrictions on the amount of interest that can be charged on overdue payments?

Interest on overdue payments can be charged at any rate agreed between the parties. If no rate of interest is agreed, the Late Payment of Commercial Debts (Interest) Act 1998 stipulates a rate of eight per cent per annum over the official interest rate announced by the Bank of England from time to time.

30 Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

Within the EU, there are no exchange controls that apply and the UK does not currently enforce any exchange control provisions against any other currency. However, the franchise agreement may specify how and when payments of continuing fees (as opposed to the initial fee) are to be converted and particularly to the conversion rates applicable.

31 Are confidentiality covenants in franchise agreements enforceable?

Legally, yes; confidentiality covenants in franchise agreements are enforceable if correctly drafted, but in practical terms enforcement may be more difficult.

32 Is there a general legal obligation on parties to deal with each other in good faith? If so, how does it affect franchise relationships?

There is no general legal obligation on parties to deal with each other in good faith, but the Code does impose an obligation on members to deal fairly with one another.

33 Must disclosure documents and franchise agreements be in the language of your country?

The Code requires franchise agreements to be drafted in or translated by a sworn translator into the official language of the country of the franchisee.

34 What restrictions are there on provisions in franchise contracts?

Article 81 of the EC Treaty prohibits agreements, decisions or concerted practices that may affect trade between member states and have as their object or effect the prevention, restriction or distortion of competition. Chapter I of the UK Competition Act 1998 mirrors article 81, but applies where agreements affect trade within the UK. These provisions apply to franchise agreements, subject to the exceptions and exemptions set out below.

An agreement will fall within the article 81 or chapter I prohibition only if it has as its object or effect an appreciable prevention, restriction or distortion of competition within the geographical areas as set out above for each provision.

In determining whether an agreement has an appreciable effect on competition, the OFT will have regard to the European Commission's Notice on Agreements of Minor Importance (the notice). This states that a franchising agreement (which is a vertical agreement) will normally fall outside article 81 (and therefore by implication, the chapter I prohibition) if the market share of each party does not

exceed 15 per cent. This threshold is reduced to five per cent where parallel networks of similar agreements cumulatively result in foreclosure of the relevant market. However, if the franchise agreement is *de minimis*, but contains hard-core restrictions, it will normally be prohibited under article 81. Vertical agreements are those between undertakings which operate at different levels of the production or supply chain. Hard-core restrictions include price-fixing and resale price maintenance. There are also dispensations for small- and medium-sized undertakings in the notice.

Many of the obligations contained in franchise agreements can be assessed as being necessary for the protection of intellectual property rights or to maintain the common identity and reputation of the franchised network. Therefore by virtue of the EC Block Exemption for Vertical Agreements, franchise agreements may fall outside the article 81(1) or chapter I prohibition. Agreements falling within the terms of the block exemption will be exempt from the chapter I prohibition as well, by virtue of section 10 of the Competition Act 1998.

The block exemption, however, will not apply if a vertical agreement contains any hard-core restrictions.

The block exemption will also only apply if the market share held by the supplier does not exceed 30 per cent of the relevant market in which it sells the contract goods or services. Additionally, in relation to agreements that contain 'exclusive supply' obligations, the block exemption only applies where the buyer also does not have more than 30 per cent of the relevant market in which it purchases the contract goods or services.

If the agreement does not relate directly to the activity of the buyer or its customers in relation to the use, sale or resale, of goods or services, the franchising agreement may fall within the application of the Technology Transfer Block Exemption.

If none of the above exemptions apply, a franchise agreement may meet the conditions for individual exemption under article 81(3) of the EC Treaty or section 9(1) of the 1998 Act, (section 9(1) mirrors article 81(3)). To qualify for an individual exemption, the overall economic benefits of the agreement must outweigh the effect on competition. Where the supplier is dominant in the market, any restrictions must be objectively justifiable.

There are no provisions regarding the duration of a franchise agreement itself. But the block exemption will not cover any direct or indirect non-compete obligations contained in a franchise agreement that run for an indefinite period of time or in excess of five years. Non-compete obligations (exclusive purchase agreements) that are renewable under the terms of a franchise agreement so that they will in effect be in excess of five years' duration are held to have been concluded indefinitely.

A non-competition restriction that is indefinite or in excess of five years on the goods or services purchased or sold by a franchisee, however, is permitted when the obligation is necessary to maintain the common identity and reputation of the franchised network. Such a restriction will then fall outside article 81, meaning that the benefit of the block exemption will not be needed and therefore the five-year limit on a non-compete clause will not apply. In these circumstances, the duration of the non-compete obligation is irrelevant as long as it does not exceed the duration of the franchise agreement.

Franchise agreements can be exclusive distribution agreements and are permitted provided they do not allow for absolute territorial protection. Other restrictions on territories or customers to which a distributor can make sales or provide services are considered hard-core restrictions. For example, a ban on passive (unsolicited) sales is a hard-core restriction. Franchise agreements containing such restrictions will fall outside the block exemption.

Direct or indirect price fixing (eg, agreeing a minimum sale price or level of discount) and resale price maintenance are hard-core restrictions. The block exemption will not apply if a franchise

Update and trends

- The trend towards securitisation of franchise revenue has been hit by the fragile credit market.
- OFT's revised guidance in mergers affecting small markets (or 'markets of insufficient importance'), *Mergers – substantive assessment guidance: Exception to the duty to refer: markets of insufficient importance* (OFT516b)
- On 15 November 2007, the OFT published revised guidance which increased the threshold for a market to be considered of insufficient importance from £400,000 to £10 million. Under the guidance, the OFT will generally consider markets worth less than £10 million in aggregate to be of insufficient importance to justify reference. Please note that the guidance continues to make it clear that the application of the de minimis threshold will not apply automatically simply because the market is worth less than £10 million. The revised guidance clarifies that the pivotal issue is whether the impact of the merger is likely to be particularly sufficient. In considering the impact of a merger, the OFT pays particular attention to the size of the market, the magnitude of the competition lost by the merger and the durability of the merger's impact.
- Since November, the revised guidance has been applied by the OFT in the following instances involving the rail franchise industry:
 - the award of the Intercity East Coast rail franchise (ICEC) to National Express Group;
 - the award of the Cross Country rail franchise to Arriva plc; and
 - the acquisition by Stagecoach plc of East Midlands Rail Franchise.

agreement includes such restrictions, but a maximum sale price restriction may be imposed.

behaviour (including entering and searching business premises with a warrant) and to impose fines.

35 Describe the aspects of competition law in your country that are relevant to the typical franchisor. How are they enforced?

36 Very briefly describe the court system. What types of dispute resolution procedures are available relevant to franchising?

See question 34. The European Commission or the UK competition law authorities may carry out an investigation into suspected competition law infringements. The European Commission will only be involved where the suspected infringements may affect trade between member states. The OFT is the principal competition law enforcement authority in the UK. The OFT's website details are as follows: www.of.gov.uk.

In civil cases, proceedings are commenced by the person who has the claim. They must try to prove the liability of the other party on the balance of probabilities. The choice of court depends in most cases on the value of the claim. Claims of lesser value will start in a county court, whereas more substantial civil claims are heard in the High Court.

The European Commission and the UK competition authorities have significant powers to investigate suspected anti-competitive

The main type of alternative dispute resolution relevant to franchisors is mediation, where a trained impartial mediator assists the parties to reach a compromise of their own volition. The BFA also offers specialist conciliation services to its members.



Peter Brook

peter.brook@dlapiper.com

India Buildings
Water Street
Liverpool L2 ONH
United Kingdom

Tel: +44 8700 111 111
Fax: +44 151 236 9208
www.dlapiper.com/uk