

Franchise 2022

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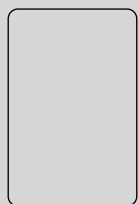
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Franchise

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Mark Kirsch
Lathrop GPM

Lexology Getting The Deal Through is delighted to publish the sixteenth edition of *Franchise*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Australia, India and United States.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editor, Mark Kirsch of Lathrop GPM, for his assistance with this volume.



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MARKET OVERVIEW

Franchising in the market

- 1 How widespread is franchising in your jurisdiction? In which sectors is franchising common? Are there any economic or regulatory issues in the market that are more or less hospitable to franchising or make it economically viable in your jurisdiction?

The franchise sector in the United Kingdom continues to grow. According to the latest franchise industry survey published in 2018 by NatWest Bank and the British Franchise Association (BFA), it is estimated that the sector contributed in excess of £17 billion to the UK economy, an increase of £2 billion since the survey was last undertaken in 2015. In that time, the number of franchise units operating has increased by almost 25 per cent. This is a trend that has almost certainly continued since then.

Given its strong economy and relatively benign regulatory environment, coupled with the fact that English is widely spoken throughout the rest of the world, the United Kingdom is internationally recognised as a popular destination for franchisors from outside of the United Kingdom looking to expand their overseas operations.

There is no doubt that, despite the covid-19 pandemic, the food and beverage market will continue to remain a buoyant sector within the franchising space, particularly given the appetite from overseas brands to expand into the United Kingdom. In addition, given the United Kingdom's ageing and health-conscious population, the number of both domiciliary care and health and fitness franchises will continue to rise.

The biggest economic challenge likely to be faced by the sector, as with all sectors in the United Kingdom, is the banks' ability to lend to prospective franchisees. However, the banks in the United Kingdom look more favourably on lending to franchised businesses as opposed to independent businesses.

Associations

- 2 Are there any national or local franchise associations? What is their role in franchising, including any impact on laws or regulations? Are there any rules of conduct or membership requirements?

The BFA is the main voluntary self-regulatory body in the franchise sector. The aim of the BFA is to promote ethical franchising in the United Kingdom. The BFA also acts as a spokesperson for the interests of the sector both on a domestic and international level. It has, for many years, successfully argued that the regulation of franchising through legislation is not necessary and would do more harm to the franchising sector than good.

Its members agree to be bound by the Code of Ethics that, at its core, promotes fair dealing between the franchisor and the franchisee from the outset of the franchising relationship through to its termination.

BUSINESS OVERVIEW

Types of vehicle

- 3 What forms of business entities are relevant to the typical franchisor?

In the United Kingdom, it is usual for a franchisor to operate as a limited liability company. This is also true for most substantial businesses operating outside of the franchising sector. A company is a separate legal entity, distinct from its directors and shareholders, which enables it to enter into contracts in its own name.

A franchisor may also operate as a limited liability partnership (LLP). An LLP combines the flexible structure of a partnership with the benefits of limited liability for its members. Like a company, an LLP has a legal personality separate from that of its members, one of which must be a natural person.

The franchisor may also operate as a sole trader or as an unlimited partnership. Unlike an LLP, an unlimited partnership is not a distinct legal entity from its partners and, therefore, its partners are jointly and severally responsible for the business's debts and liabilities.

Regulation of business formation

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

Companies are formed under and governed by the Companies Act 2006, and LLPs are formed under and governed by the Limited Liability Partnership Act 2000. Unlimited partnerships are governed by the Partnership Act 1890.

Requirements for forming a business

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

Companies must be registered at Companies House. In order to incorporate a company, those looking to set one up will need to pick a suitable company name, identify an address that will act as the registered office address of the company, have at least one director that is a natural person and have at least one shareholder. Companies also need to adopt a set of articles of association, which are the written rules that will govern the running of the company and relationship between the shareholders. Companies generally use standard model articles, but these can be tailored to the company's structure or business. Once incorporated, Companies House will issue an incorporation certificate and company number. A set of company books must be maintained that detail certain information about the company and should be updated to reflect any changes. Certain changes and information will need to be filed at Companies House, including confirmation statements (detailing the shareholders) and company accounts. When incorporating,

companies are required to identify and record the people who own or control the company, known as People with Significant Control (PSC). Information about a company's PSC is kept within a central public register at Companies House. The PSC register helps to increase transparency over who owns and controls UK companies.

Limited liability partnerships must also be registered at Companies House. They are also required to file annual confirmation statements, annual accounts and update Companies House of any changes to its membership or registered office address. There is no specific requirement within the Limited Liability Partnerships Act 2000 for an LLP to have an LLP agreement. In the absence of such an agreement, the governance of the LLP is detailed in the default provisions set out in the Limited Liability Partnerships Regulations 2001. It is unlikely that the default provisions set out in those Regulations would be adequate for the governance of most modern LLPs. LLPs are also required to provide information about its PSC to Companies House.

Partnerships are not registered at Companies House and are deemed to have been formed once they satisfy the definition of a partnership under the Partnership Act 1890. The governance of a partnership is detailed in the Act, except where the provisions of the Act have been amended by any partnership agreement entered into between the partners. As with LLPs, it is unlikely that the provisions set out in the Act would be adequate for the governance of most modern partnerships.

Restrictions on foreign investors

6 | What restrictions apply to foreign business entities and foreign investment?

The United Kingdom is a popular destination for foreign businesses seeking to expand overseas. Business regulation in the United Kingdom is relatively light-touch, as evidenced by its approach to franchising.

The Department for International Trade promotes foreign businesses trading in the United Kingdom and encourages investment from overseas. In general, there are no restrictions on ownership by foreigners of UK assets and foreign businesses and individuals are allowed to be both shareholders and directors in UK companies. UK immigration laws highlight how foreign investment is encouraged, allowing individuals from overseas to apply for visas based on their investment into certain UK companies. Of course, since Brexit, citizens of EU member states no longer have the automatic right to live and work in the United Kingdom, which may make franchising more complicated in some instances.

Taxation

7 | What aspects of the tax system are relevant to franchisors? How are foreign businesses and individuals taxed?

UK-resident companies are required to pay corporation tax on their worldwide profits. Companies are taxed based upon their accounting reference period and can choose when their accounting period ends. Companies are required to file their annual accounts with a tax return with Her Majesty's Revenue and Customs (HMRC) within 12 months of the accounting reference period. The accounts must also be filed with Companies House (there is reduced disclosure for smaller companies) and, therefore, the accounts become a matter of public record.

A non-resident company will not be liable to tax merely as a result of trading with UK businesses. However, when a non-resident company is trading through a permanent establishment in the United Kingdom (or is controlled from the United Kingdom), it will be subject to corporation tax on the profits made by that permanent establishment. Any corporation tax suffered in the United Kingdom by a non-resident company may be reduced or eliminated under a relevant double tax treaty (DTT). In some cases, accounts from the permanent establishment are also required to be filed at Companies House.

Where a franchisor establishes a UK-resident subsidiary, that company will be taxed in its own right, as set out above.

LLPs are not subject to corporation tax, but members, as with partners in a partnership, will be taxed individually.

The tax year for individuals ends on 5 April and an individual is taxed on the profits of his or her accounts during that tax year. He or she can choose when his or her accounting year ends. The accounts are required to be filed with a tax return with HMRC on or before 31 January following the end of the tax year.

Individuals are now subject to a statutory residency test that determines if that person is resident in the United Kingdom or not. The test is based on both the number of days of physical location in the United Kingdom and some further connection factors.

An individual resident in the United Kingdom is taxed on his or her worldwide profits and capital gains (although in some cases resident but non-domiciled individuals may only be taxed on profits remitted to the United Kingdom). As a general rule, individuals who are non-resident in the United Kingdom will be liable to income tax on profits arising in the United Kingdom. However, the DTT with the country in which they reside will determine which country has the taxing rights and any income tax suffered in the United Kingdom is likely to be relievable against tax in their domestic country in accordance with the DTT.

A non-resident company or individual generating royalties, licence fees and interest in the United Kingdom may suffer a withholding tax on that income retained and paid to HMRC by the paying company. The DTT between the United Kingdom and the company's or individual's country of residence may reduce the rate of the withholding tax. The non-resident may be able to recover this withholding tax against their own domestic tax.

The franchise agreement therefore should stipulate whether the franchisee is obliged to gross up any payment or cooperate with the franchisor in recovering any sums paid to HMRC (where appropriate) under any DTT.

Labour and employment

8 | Are there any relevant labour and employment considerations for typical franchisors?

There are a number of employment law duties and discrimination protections that franchisors must be mindful of (some are 'time served' protections and others are 'day one' employee rights).

The employment disputes environment had become relatively benign because, in 2013, the government introduced a fee to be paid to progress an employment claim in the tribunal system. However, this fee was quashed by the Supreme Court in 2017 and the number of claims has risen sharply as a consequence.

In addition to this, there are a range of business immigration controls for franchisors to consider for any employees of the franchisor following the end of free movement post-Brexit. Employers must now sponsor individuals to work in the United Kingdom if they are not 'settled workers' or do not have some other immigration permission allowing them to work in the United Kingdom. EEA and Swiss nationals (and their eligible family members) who were already in the United Kingdom before 11pm on 31 December 2020 must apply for 'settled' or 'pre-settled' status under the EU Settlement Scheme by 30 June 2021 and that application must be granted, or they will be in the United Kingdom illegally from 1 July 2021. EEA nationals who arrive in the United Kingdom after 11pm on 31 December 2020 will need to be sponsored under the Skilled Worker visa, or the Intra-Company or Temporary Worker routes unless they can evidence that they have another type of immigration permission enabling them to work in the United Kingdom.

The area of employment status has been a fast-moving area of case law development in recent years and it is entirely possible, if the relationship is not structured and documented correctly, for a relationship described as franchisor and franchisee to be deemed to be one of employer and employee or engaged worker. For the staff of franchisors, employment status is also a prevalent issue as they determine whether staff should be employees, workers or contractors.

There have also been legal challenges in the use and perceived abuse of 'zero hours' contracts, whereby workers are not entitled to any specified number of hours' work.

Intellectual property

9 | How are trademarks and other intellectual property and know-how protected?

Trademarks in relation to goods or services can be registered at the Intellectual Property Office (IPO) as a UK mark or at the European Union Intellectual Property Office as a community mark.

Anyone considering franchising in the United Kingdom should ensure that its trademarks are registerable, as the registration of the trademark normally gives the owner the exclusive right to prevent others from using the mark and there is a market expectation that any trademark being licensed is registered or at the very least in the process of being registered.

The registration of trademarks at the IPO is a relatively simple and inexpensive process so long as no opposition to the registration is lodged.

As a result of Brexit, with effect from 1 January 2021, the IPO will create a comparable independent UK trademark for every registered EU trademark, which will have same legal status as if registered under UK law. The UK trademark will keep the original EU trademark filing date.

Where franchisors have applications pending for EU trademarks as at 1 January 2021, although they will not automatically obtain a comparable UK trademark, they will have nine months to apply in the United Kingdom for the same protection. A fee will be payable, and the application will be examined and published in the usual way.

Where a franchisor has either not yet registered or cannot register a trademark, the franchisor may have a claim for 'passing off' if a competitor imitates the goods or services it offers in such a way that the public believes them to be those of the franchisor. A claim will be successful if there is goodwill and a reputation attached to the goods or services it offers, and the franchisor has suffered a loss.

Know-how relating to the franchise system will invariably be detailed in the system's manual. It cannot be protected by registration and is, therefore, protected through the franchise agreement. The franchise agreement will contain a requirement on the franchisee to keep any know-how and other confidential information belonging to the franchisor confidential both during and after the currency of the franchise agreement.

Real estate

10 | What are the relevant aspects of the real estate market and real estate law? What is the practice of real estate ownership versus leasing?

Property law in England and Wales is based on the common law system and as such proprietary interests in land derive from either freehold or leasehold interests. How the property from which the franchise business operates is occupied usually depends on the franchisor's business model and it is crucial that the agreements to occupy any premises dovetail with the franchise agreement.

It is common for a franchisee to take a direct lease, in which case the franchisor may require step-in rights, which can usually be exercised (depending on the terms of those step-in rights) in the event of

default by the franchisee of the terms of the lease or termination of the franchise agreement. These would allow the franchisor to take on the franchisee's rights and obligations under the lease.

Where the premises are critical to the success of the franchise, the franchisor may take a head-lease and grant a sub-lease to its franchisee. This allows the franchisor to have more control over the premises, but comes with an increased financial risk.

If the franchisor owns the freehold itself and grants a direct lease to its franchisee or is granting a sub-lease to the franchisee, it is crucial that the security of tenure provisions otherwise conferred by the Landlord and Tenant Act 1954 are excluded, so that the franchisor retains an element of control over the occupation of the premises, otherwise the franchisee tenant can benefit from a right to occupy the premises after expiry of the lease, and even have a right to request a new lease. This legislation does not apply in Scotland, which has a different real estate system.

Competition law

11 | What aspects of competition law are relevant to the typical franchisor in your jurisdiction? How is competition law enforced in the franchising sector?

Chapter I of the Competition Act 1998 prohibits agreements that may affect trade within the United Kingdom, and have as their object or effect the prevention, restriction or distortion of competition within the United Kingdom. In practice, post-Brexit, franchisors operating within the United Kingdom will initially see no substantive change to the competition law regime, as Chapter I was modelled on article 101 of the Treaty of the Functioning of the European Union. Although article 101 no longer applies in the United Kingdom, it will apply to UK businesses that enter into agreements that have an effect in the European Union.

Whether a franchise agreement falls within the scope of Chapter I of the Competition Act 1998 will depend on a number of factors, including the parties' relevant market share. In practice, most franchisors draft their agreements so that they benefit from safe harbour provisions and fall within the vertical restraints block exemption (the Block Exemption Regulation). The Block Exemption Regulation was retained in UK law post-Brexit and is currently under review by the UK government. If the franchise agreement falls within the terms of the Block Exemption Regulation, it will be exempt under Chapter I of the Competition Act 1998. For example, a five-year initial term is common in franchise agreements, so that the non-compete provisions contained within it do not fall outside of the benefit of the Block Exemption Regulation.

Furthermore, any hardcore restrictions contained in the franchise agreement will lead to the exclusion of the franchise agreement from the scope of the Block Exemption Regulation. These include an obligation on franchisees to sell the goods and services for a minimum price (resale price maintenance) or restrictions on franchisees from responding to unsolicited requests from customers to provide goods to services outside of an agreed territory (passive sales). Restrictions on passive sales also prevent franchisors from prohibiting franchisees from operating their own websites, but not from setting a requirement that such websites meet certain specifications.

Competition issues are regulated domestically by the Competition and Markets Authority. Sanctions include financial penalties or the voiding of provisions within the franchise agreement.

OFFER AND SALE OF FRANCHISES

Legal definition

12 | What is the legal definition of a franchise?

There is no legal definition of franchising under UK law and as such is an indication of the absence of regulation in the sector. However, the British Franchise Association's (BFA) Code of Ethics defines franchising as:

[A] system of marketing goods or services and/or technology which is based upon a close and ongoing collaboration between legally and financially separate and independent undertakings, the franchisor and its individual franchisees, whereby the franchisor grants to its individual franchisees the right, and imposes the obligation, to conduct a business in accordance with the franchisor's concept.

Laws and agencies

13 | What laws and government agencies regulate the offer and sale of franchises?

There are no government agencies or specific legislation that regulate the offer and sale of franchises.

However, the BFA Code of Ethics places obligations on member franchisors in relation to the offer and sale of franchisees. Membership of the BFA is voluntary.

Franchising arrangements may be subject to the Trading Schemes Act 1996 and the Trading Schemes Regulations 1997, which were enacted to tighten up the existing legislation regulating pyramid selling through trading schemes, namely the Fair Trading Act 1973. Franchisors must be mindful of the legislation owing to its broad drafting.

The Trading Schemes Regulations 1997 (the Regulations) do not place a prohibition on trading schemes. However, in the event that the franchising relationship is considered a trading scheme, then the Regulations place obligations on franchisors in relation to advertising and can impose contractual requirements, including a cooling-off period. These requirements would make franchising an unattractive business model. Therefore, in practice, franchise networks in the United Kingdom are structured to ensure that a franchisor is exempt from the legislation.

A franchisor can ensure that it is exempt from the legislation by either operating as a single tier (namely by having one level of franchisee) or by being, and making certain that all the franchisees (and all other relevant participants) are, value added tax-registered.

If the franchisor is unable to benefit from one of the exemptions and subsequently breaches the legislation, it may become subject to criminal sanctions or the franchisor may find itself subject to civil claims from a franchisee for breach of its statutory duties. In addition, any obligation on the franchisee to pay fees to the franchisor will be unenforceable.

Principal requirements

14 | What are the principal requirements governing the offer and sale of franchises under the relevant laws?

Where franchisors are members of the BFA, they are required under the terms of their membership, but not as a matter of law, to comply with the Code of Ethics to ensure that all advertising for the recruitment of franchisees is free of ambiguity and misleading statements.

Franchisor eligibility

15 | Must franchisors satisfy any eligibility requirements in order to offer franchises? Are there any related practical issues or guidelines that franchisors should consider before offering franchises?

There are no specific laws or regulations.

The BFA Code of Ethics requires that, prior to franchising, the franchisor has operated at least one pilot unit, has the right to use its brand, and provides its franchisees with initial training and continuing assistance.

It is important to note that where, as part of the process of offering and subsequently awarding the franchise, the franchisor requests that the franchisee pay a deposit, the BFA Code of Ethics stipulates that the deposit must be refundable, subject to the franchisor retaining any quantifiable directly related expenses incurred by it and that the terms upon which any deposit is taken are set out in writing.

Franchisee and supplier selection

16 | Are there any legal restrictions or requirements relating to the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers? What practical considerations are relevant when selecting franchisees and suppliers?

No, there are no such laws or regulations.

However, the BFA Code of Ethics states that the franchisor may only select and accept franchisees who appear to possess the basic skills, education, personal qualities and financial resources to carry on the franchise business.

Pre-contractual disclosure – procedures and formalities

17 | What procedures and formalities for pre-contractual disclosure are required or advised in your jurisdiction? How often must the disclosures be updated?

There is no legal requirement to disclose information to a prospective franchisee and as such there are no procedural formalities.

The BFA Code of Ethics requires that franchisees are provided with an up-to-date copy of the Code, along with a full and accurate written disclosure of all information material to the franchise relationship within a reasonable time prior to execution of the franchise agreement.

Even where a franchisor is not a member of the BFA, it should consider preparing some form of disclosure document to give to prospective franchisees to enable it to give accurate and consistent responses to due diligence enquiries.

Pre-sale disclosure to sub-franchisees

18 | 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 legal requirement to disclose information to a prospective sub-franchisee.

Where the sub-franchisor is a member of the BFA, given that there is an obligation under its Code of Ethics to provide franchisees with a full and accurate written disclosure of all information material to the franchise relationship within a reasonable time prior to execution of the franchise agreement, this would include, at a very minimum, disclosure of the fact that the sub-franchisor is licensed by the franchisor to grant franchises. In any event, it is advisable for a sub-franchisor to explain clearly its relationship with the franchisor to its prospective franchisees.

Due diligence

19 What due diligence should both the franchisor and the franchisee undertake before entering a franchise relationship?

The franchisor should satisfy itself that franchisees are of suitable character, and have the necessary skills base and (if applicable) qualifications to operate the franchise. Franchisors should also ensure that franchisees have sufficient funding to both open and operate the franchise. It is important to ensure that the individuals who will be operating the franchise have the legal right to reside in the United Kingdom throughout the term of the franchise agreement.

A franchisee should review in detail any disclosure document provided by the franchisor, to ensure an understanding of the costs involved in running the franchise and the expected financial returns. A franchisee should check that the franchisor has the right to licence the relevant trademarks to the franchisee, and it is market practice for a franchisee to instruct a lawyer to prepare a report on the franchise agreement highlighting its key commercial terms and any issues that should be raised with the franchisor. A franchisee should enquire about the number of franchises within the network, including the number of franchise failures, and speak to existing franchisees to understand their views on operating within the network.

Pre-contractual disclosure – content

20 What information is the disclosure document required or advised to contain?

Although there is no legal requirement as to what information is disclosed to a prospective franchisee, the BFA Code of Ethics sets out the type of information that its members are required to disclose. Even where a franchisor is not a member of the BFA, it should consider preparing some form of disclosure document providing similar information.

Under the BFA Code of Ethics, franchisors must give prospective franchisees all information that they require to be able to make a properly informed decision about whether to invest in a franchise. This will include:

- the financial status of the franchisor;
- how long the franchisor has been operating and franchising;
- information about the franchise's directors and key individuals within the franchise;
- a description of the franchise's business model;
- proper verifiable financial forecasts of the franchise model;
- information about the performance of the network;
- details of franchisees;
- details of any 'purchasing incentives' or commissions; and
- a copy of the franchise agreement.

Failure to disclose – enforcement and remedies

21 What actions may franchisees or any relevant government agencies take in response to a franchisor's failure to make required disclosures? What legal remedies are available? What penalties may apply?

A franchisor could find itself the subject of a claim for misrepresentation from a franchisee. Such a claim would arise if the franchisor were to make an untrue statement of fact that induces the franchisee to enter into a franchise agreement. This would typically be some form of earnings claim with little basis in fact. Depending on the circumstances in which the statement is made, the franchisor may then be subject to a claim for one or more of innocent, negligent or fraudulent misrepresentation. Such statement can be made either orally or in writing. In the case of a successful claim for misrepresentation, depending on the

facts, the franchisee will be able to rescind the agreement or, where it has suffered loss, claim for damages, or both. If the misrepresentation was innocent, then the court may rescind the agreement or award damages in lieu of rescission, but not both. In the case of fraudulent or negligent misrepresentation, a court can award damages and rescind the agreement. If an agreement is rescinded, the parties are restored to the position in which they would have been had the agreement never been entered into.

The franchisor will invariably insert provisions into the franchise agreement to restrict or exclude liability for misrepresentation. The effectiveness of such clauses is subject to both statute and common law. Where a clause seeks to limit liability for misrepresentation, it would be subject to the test of reasonableness under the Unfair Contracts Terms Act 1977. Any clauses seeking to restrict or exclude liability from fraudulent misrepresentation will be ineffective. The case of *Papa-Johns (GB) Ltd v Doyley* [2011] makes it clear that the courts are reluctant to allow franchisors to benefit from such provisions due to the inequality of bargaining power and, as such, franchisors should ensure that they are careful and organised about the information provided to franchisees rather than solely relying on exclusion or limitation of liability clauses.

Failure to disclose – apportionment of liability

22 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?

Where a sub-franchisee has a claim for misrepresentation, it will be against that the appropriate sub-franchisor and not the franchisor. On the assumption that the franchisor or the sub-franchisor is a limited liability entity then individual officers, directors or employees will not generally be exposed to personal liability.

General legal principles and codes of conduct

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

The offer and subsequent sale of franchises will be subject to general principles of contract and tort law, and therefore the laws relating to misrepresentation will offer protection to franchisees.

The parties must be mindful of the concept of caveat emptor (buyer beware) and, therefore, carry out an appropriate level of due diligence. The concept of *culpa in contrahendo*, common in civil jurisdictions, places a duty to negotiate with care that could extend to making pre-contract disclosures and does not apply in the United Kingdom. Nor is there, as the law currently stands, a general implied duty of good faith.

Fraudulent sale

24 What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises?

A franchisee can claim against the franchisor for fraudulent misrepresentation and, if successful, may rescind the agreement and claim damages.

Any clauses in the franchise agreement that seek to restrict or exclude liability from fraudulent misrepresentation will be ineffective.

**FRANCHISE CONTRACTS AND THE FRANCHISOR/
FRANCHISEE RELATIONSHIP**

Franchise relationship laws

25 | What laws regulate the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

There are no specific laws that regulate the ongoing relationship between the franchisor and the franchisee after the franchise contract comes into effect.

Operational compliance

26 | What mechanisms are commonly incorporated in agreements to ensure operational consistency and adherence to brand standards?

Franchise agreements will normally contain an obligation on franchisees to provide the franchisor with financial information including management accounts, annual accounts and value added tax returns (if applicable) enabling the franchisor to both monitor the franchisee's financial performance and to provide guidance and feedback on it. Where applicable, franchisees should allow franchisors online access to this data. Franchisees may also be required to provide the franchisor with a business plan each year.

In addition, there will typically be an ability for the franchisor to carry out a complete audit of the franchisee's business to ensure compliance with operational standards. Where the franchisee's business is falling below those standards there will be a requirement to remedy those failings. In the event that the franchisee fails to do this then such a provision may allow the franchisor to treat the failure as a breach of the franchise agreement, remove a franchisee's territorial exclusivity or terminate the franchise agreement.

Amendment of operational terms

27 | May the franchisor unilaterally change operational terms and standards during the franchise relationship?

Yes, the franchise agreement will allow the franchisor to unilaterally change the operational terms and standards by amending the franchise manual, with which the franchisee will be required to comply. This assumes that the change does not conflict with the franchise agreement. While the franchise agreement will contain an obligation on the franchisee to comply with the manual in its entirety, where there are key policies and procedures that the franchisor envisages being updated periodically, it is advisable that the franchise agreement makes specific reference to the franchisee's need to comply with those policies and procedures.

Policy affecting franchise relations

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

There are no mandatory government or trade association policies affecting the franchise association.

Voluntary members of the British Franchise Association (BFA) are required to comply with its Code of Ethics.

Termination by franchisor

29 | 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?

The circumstances in which a franchisor may terminate the franchise relationship are detailed in the franchise agreement. Typically, there is a right to terminate the franchise agreement with immediate effect if the franchisee ceases to operate the business, brings the brand into disrepute, commits a criminal offence, is the subject of an insolvent event or proceedings in the case of repeated breaches of the franchise agreement, or if there is a failure to remedy a breach within an agreed time frame.

The franchisor also has the right at common law to terminate the franchise agreement in the event of a repudiatory breach of it by the franchisee. A repudiatory breach is essentially a breach that goes to the core of the contract and deprives the innocent party of its benefit.

Termination by franchisee

30 | In what circumstances may a franchisee terminate a franchise relationship?

Generally, a franchise agreement will not contain any express provisions allowing the franchisee to terminate it prior to the expiry of its term. However, the franchisee has the right at common law to terminate the franchise agreement in the event of a repudiatory breach of it by the franchisor.

Renewal

31 | How are renewals of franchise agreements usually effected? Do formal or substantive requirements apply?

The franchisee will be required on renewal to enter into the franchisor's standard franchise agreement. There are no laws setting out how franchise agreements are to be renewed or containing any requirements to be complied with on their renewal. Typically, there will be an obligation on the franchisee to notify the franchisor that it wishes to renew the franchise agreement during a time period specified in the franchise agreement.

Refusal to renew

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

There are no laws stipulating whether and on what terms the franchisor must renew the franchise agreement. Furthermore, there is no requirement under the BFA Code of Ethics that there must be a renewal of the franchise agreement.

The basis of renewal is a contractual one and the franchise agreement will set out conditions that must be met for the franchisor to agree to renew it. These will typically include a requirement that the franchisee is not in breach of the agreement, pays a renewal or administration fee and undertakes any required updates of its business operations or premises.

Transfer restrictions

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

A franchisor can and normally does restrict such transfers. The franchise agreement usually stipulates that the franchisor's consent to any transfer is required, which will be given subject to certain conditions

being met. These conditions include the franchisor being satisfied that the prospective purchaser is a suitable candidate as a franchisee and the franchisee paying all sums owed to the franchisor, as well as certain costs associated with the transfer process. These provisions normally contain a right of pre-emption in favour of the franchisor, allowing it to buy the franchise business from the franchisee.

Fees

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

There are no such laws or regulations.

Usury

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

A franchisor may impose interest on overdue payments, which is typically specified in the franchise agreement. However, a franchisor must be wary that if the rate of interest is too high it may be considered a penalty clause and, therefore, be unenforceable.

Where no express provision is included in the franchise agreement, the default rate pursuant to the Late Payment of Commercial Debts (Interest) Act 1998 shall apply and currently stands at 8 per cent above the Bank of England base rate.

Foreign exchange controls

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

Generally, there are no such laws or restrictions. However, in the event that a franchisor is operating in a country on which the United Kingdom has imposed financial sanctions, then restrictions may apply.

Confidentiality covenant enforceability

37 | Are confidentiality covenants in franchise agreements enforceable?

Yes.

Good-faith obligation

38 | Is there a general legal obligation on parties to deal with each other in good faith during the term of the franchise agreement? If so, how does it affect franchise relationships?

As the law currently stands, there is no general legal obligation on the parties to a franchise agreement to deal with each other in good faith.

Case law on this has been unsettled on this subject for some time. In *Yam Seng Pte Ltd v International Trade Corporation Ltd* (2013), the courts commented on the importance of recognising the concept of good faith in 'relational contracts', including franchise agreements. However, in *Carewatch Care Services Ltd v Focus Caring Services Ltd* (2014), the courts dismissed an argument from the franchisee that the franchise agreement contained an implied term that the franchisor and franchisee act in good faith towards each other. The courts took the view that, as the franchise agreement contained detailed terms dealing with all aspects of the franchise relationship, it was not necessary to imply any further terms.

Recent case law has suggested that the courts are becoming ever more willing to imply a duty of good faith into certain contracts, potentially including franchise agreements. In the case of *Sheikh Tahnoon Bin Saeed Bin Shakhboot Al Nehayan v Kent* (2018), it was held that the

parties to a joint venture arrangement, entered into orally, owed each other a duty of good faith. Subsequently in *Bates v Post Office* (2019), it was held that a duty of good faith should apply as a matter of law to all 'relational' contracts and provided some guidance as to what a 'relational' contract might be. Under this guidance, franchise agreements may well be classed as relational contracts. However, in the case of *TAGA Bratani v Rockrose* (2020), the courts made it clear that the status of a contract as 'relational' did not automatically imply that the parties owed each other a duty of good faith.

The BFA Code of Ethics requires parties to a franchise agreement to exercise fairness in their dealings with each other, and to resolve complaints, grievances and disputes with good faith.

Franchisees as consumers

39 | Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

Franchisees are not currently treated in law as consumers.

Language of the agreement

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

There is no such legal requirement. However, the BFA Code of Ethics requires that the franchise agreement is translated into the language of the franchisee's country and in which the franchisee is competent.

Restrictions on franchisees

41 | What types of restrictions are commonly placed on the franchisees in franchise contracts?

Given the nature of franchise systems and the level of control that franchisors will wish to retain over the network, during the term of the franchise agreement franchisees will typically be subject to a number of restrictions. These include obligations to operate from specific premises or within specific territories, to purchase certain products or services from the franchisor or its nominated suppliers and not to be involved or interested in another business. Franchise agreements may also place restrictions on franchisees from selling goods or services above a particular price.

In addition, after the term of the franchise agreement, franchisors will seek to restrict franchisees from being involved or interested in a competing business from the premises or the territory in which the franchisee previously operated from or from competing with the rest of the network. These may also include restrictions on poaching certain employees or soliciting customers. While these restrictions will only be enforceable to the extent that they go no further than are reasonably necessary to protect the franchisor's legitimate business interests, recent case law makes it clear that well-drafted post-termination restrictive covenants that last for no longer than a year after termination or expiry of the franchise agreement are likely to be enforceable.

Courts and dispute resolution

42 | Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The United Kingdom is made up of more than one legal jurisdiction, with England and Wales along with Scotland being the largest two jurisdictions. Civil claims proceed differently in each jurisdiction, although the burden of proof is the same; namely, the balance of probabilities. In England and Wales, a franchisor would be expected to follow a pre-action protocol prior to commencing proceedings. A claim would be heard in either a local county court or the High Court. The High Court

will ordinarily only hear claims with particular complexity, high value or cross-jurisdictional elements. Claims in Scotland proceed in the local sheriff court or in the Court of Session. Unlike in England and Wales, a claim can be commenced without the need to follow a pre-action protocol.

There is a strong emphasis on resolving disputes without resorting to litigation and different forms of alternative dispute resolution, such as mediation, are encouraged. Unreasonably refusing to engage in alternative dispute resolution can result in a party being punished in costs, regardless of whether they are the successful party at court. The BFA runs a mediation and arbitration scheme to resolve franchise disputes. It is common for franchise agreements to contain provisions requiring the parties to consider mediation before commencing proceedings, or that disputes are to be resolved by way of arbitration, rather than through the courts.

Given the length of time that claims take to progress through the court system, which can be years rather than months, some franchisors and franchisees are choosing to resolve their disputes through arbitration.

Governing law

43 Are there any restrictions on designating a foreign governing law in franchise contracts in your jurisdiction? How does the governing law affect the contract’s enforceability?

There are no restrictions on designating a foreign governing law in franchise agreements. However, the parties to the agreement will remain subject to certain mandatory laws that will apply notwithstanding the choice of jurisdiction, for example the Transfer of Undertakings (Protection of Employment) Regulations 2006.

Arbitration – advantages for franchisors

44 What are the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction? Are any other alternative dispute resolution (ADR) procedures particularly favoured or disfavoured in your jurisdiction?

The advantages of arbitration in the United Kingdom are similar to most jurisdictions, in that it generally offers a speedier and potentially less costly alternative to court proceedings, hearings are confidential to the parties and if the matter has particularly technical points an arbitrator with relevant expertise can be selected. The London Court of International Arbitration is recognised as a world-leading institution. The United Kingdom is a signatory to the New York Convention, allowing for enforcement of arbitral awards through convention protocols.

The parties to a franchise agreement may also decide to mediate. The Centre for Effective Dispute Resolution is a respected organisation offering mediation services. Members of the BFA also benefit from its mediation scheme.

National treatment

45 In what respects, if at all, are foreign franchisors treated differently (legally, or as a practical matter) from domestic franchisors?

Foreign franchisors are treated in the same way as domestic franchisors.



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UPDATE AND TRENDS

Legal and other current developments

46 Are there any proposals for new legislation or regulation, or to revise existing legislation and regulation? Are there other current developments or trends to note?

Trends

Following the United Kingdom’s exit from the European Union on 31 January 2020, the transition period expired on 31 December 2020, which means that the United Kingdom has ceased to be subject to EU law and the jurisdiction of the European Court of Justice. The majority of the EU laws that applied in the United Kingdom at the end of 2020 were retained under UK law. The Withdrawal Act ensures that even direct EU legislation is treated as having formed part of domestic law. Given this, any divergence between EU and UK law is likely to follow as domestic legislation is amended, and EU and UK case law evolve.

Update

The vertical restraints block exemption (the Block Exemption Regulation) offers a safe harbour in relation to competition law infringement and was retained in UK law post Brexit. It is currently under review by the UK government, with the current regulations expected to be varied or replaced at the end of May 2022. According to the government:

[T]heretained [Block Exemption Regulation] largely delivers what it was intended to deliver, but it should be examined rigorously to ensure that it takes account of any specific features of the UK economy so that it serves the interests of UK businesses and consumers.

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