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Franchising

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Franchising is a method of marketing goods and services and consequently, a business model. Franchising authorises, by granting a license, use of a company's operating system and the right to use intellectual property associated with that business. It replicates a business and managing system providing an enterprise, the franchisor, to expand its existing business model to another enterprise, the franchisee (Hoy, Perrigot and Terry [2017]). The franchisor and franchisee are legally and commercially independent entities (WIPO [2019]). The franchisor develops a blueprint for conducting the business, imparts the knowledge, and trains the franchisee to establish a successful clone (Mendelsohn [1996]). Nowadays, the matter of franchising resides in this 'business format' (Buchan [2014]), where there is a comprehensive and continuing relationship between the two parties under a controlled environment (Mendelsohn [1996]). Any developed and successful economic activity like manufacturers, wholesalers, processing, and or distribution of goods and or services are capable of being franchised.

The origin of franchising took place during the eighteenth century in the pub business in the United Kingdom, where brewers offered financial support for exchange of exclusivity (Lexology [2019]). In the nineteenth century, several distribution arrangements took place in the United States, starting with the production and selling of sewing machines by Isaac Singer (Stetsiuk, Miroshnychenki and Dudko [2018]). This model was developed further with Henry Ford's automobile assembly line. Reaching the twentieth century, there is now the most well-known business and management format created by Ray Kroc's fast-food chain McDonald's (Hoy, Perrigot and Terry [2017]).

The regulatory environment and the protection of the franchise system's scope and limitations are protected under traditional commercial law like contract and intellectual property. Franchising does not need a specific legislation to be able to function and be efficient, and countries use different terms to regulate it, differing between civil law and common law. Few countries (Brazil, Korea, Russia, and Malaysia) have specific franchising laws; Australia has a Franchising Code of Conduct which is obligatory; others like South Africa regulate franchising under consumer protection law; the Association of Southeast Asian Nations use consumer and competition law (Buchan [2014]); and Japan, and some states in the United States, regulate the relationship of the franchise. Generally, there are a range of laws impacting franchise systems and consideration is given to, aside from contract law and intellectual property law, competition law, consumer protection, employment law, data protection, and money laundering. Certain countries, such as Korea and Brazil, require pre-contractual disclosure laws including its registration, which if ignored, may lead to the contract being null and void; other countries require for the franchise agreement to be registered (Bowler [2022]). The latter shall contain serial numbers of all intellectual property to make agreements enforceable against third parties, and to permit remittance of money when countries regulate foreign investments (European Commission [2020]). Indonesia establishes that without registration of intellectual property there cannot be franchising (Santoso [2018]).

The protection sought is from infringement by third parties and deterioration and malpractices by the franchisor and franchisee. Usually, under contractual obligation, the franchisor takes an active role and protects and defends the intellectual property rights used in the franchise system (Arnestal and Fernlund [2016]). Intellectual property is at the heart of a franchise and in both common law and civil law systems, intellectual property may protect certain elements of franchising. There are other areas qualifying as intangible property not protected by intellectual property law but by contract law, like confidentiality agreements (Muulin and Wu [2016]).

Most countries and even regions have created associations protecting and promoting franchising e.g., Brazilian Franchise Association, European Franchise Federation, and the World Franchise Council and the International Franchising Association. Code of Ethics are produced by many countries and regions e.g., Europe, South Africa, and the United Kingdom. The World Intellectual Property Organization published the Franchising Guide; while the International Institute for the Unification of Private Law (UNIDROIT) and the International Chamber of Commerce (ICC) have tried to establish common rules for franchise agreement (Stetsiuk, Miroshnychenki and Dudko [2018]).

The *intellectual property rights* in franchising arrangements nearly always include the franchisor's trademark. **Trademarks** are a **sign**, like a logo, **slogan** or **words** identifying the origin of goods and or services and distinguishes it from other goods and services. Trademark provides brand recognition and attracts customers and consequently, the franchisee will benefit immediately from the trademark as the user has an experience associated with it (Mendelsohn [1996]). While there is no requirement for franchising to register its trademark, ownership and rights are acquired by registration in the country where the franchisee is to operate; in some countries, rights in a trademark can derive from its **genuine use**.

Franchising also involves use of literal and artistic works which is protected under copyright e.g., operation manuals, menus, advertising, decoration, and computer software. It does not require registration in accordance with the Berne Convention. However, registration is possible in several countries (Argentina, China, Colombia, Japan, Kenya, and Spain) creating a voluntary registration which can be used in court as evidence of **copyright ownership**, while the United States requires registration as a prerequisite to file suit for infringement.

Shapes, patterns, colours, and appearance of a good and or service e.g., uniforms, shops entrance, or interior of a room, may be protected under **industrial design** by applying for a design right usually at the national intellectual property office. Technological inventions may be protected under **patents** and in need of registration in the country where the franchisee plans to operate. Any enhancement and improvements made by the franchisee to the patent may be required to be licensed or assigned to the franchisor (WIPO [2019]). Clauses establishing that improvements developed by the licensor may only be used by the franchisee upon execution of a new agreement may be challenged by national intellectual property offices (European Commission [2020]).

There are other rights that although not intellectual property rights as such, are subject matter protected under the Paris Convention for the Protection of Industrial Property.

Unfair competition, know-how and **trade secrets** are rights found in franchising.

Structure arrangements between franchisor and franchisee are developed in different formats which may have multiple operators depending on the agreement within the country or internationally. The latter would have implications of transnational arrangements such as tax and financial issues which may affect the structure (Mendelsohn [1996]). The structure and operations are described in the following forms: A *direct franchise* which involves a direct and individual agreement between the franchisor and one or more franchisees; common structure in domestic situations. There is the *development franchise* involving a developer who is given the right to open several units within a timeframe and location; units are developed in an assigned territory and the franchisee will not sub-franchise out to other parties. Finally, the *master franchise* involves a sub-franchisor who has exclusive rights within a country to open its units and or to sub-franchise (Mendelsohn [1996]; WIPO [2019]). In a franchisee agreement, there can be a combination of these structures which may include **exclusive** licences.

There are three principal *business format types* of franchises depending on their function. A *manufacturing or processing franchise* where the franchisor grants the right to the franchisee to manufacture and sell a product under the franchisor's mark; it may include a licence to use a patent and or a trade secret like the automotive, food and drink industry. In a *service franchise*, the franchisor creates a service that a franchisee renders e.g., technology services, automotive repairs, gyms, and hotels. In a *distribution franchise*, the franchisor manufactures products and sells it to the franchisee who sells it under the franchisor's mark (WIPO [1994]).

All *rights and obligations* are annotated in the franchise agreement. This contains provisions and covenants governing use of the franchisor's intellectual property and other rights and provisions. The franchise agreement is regarded as the core instrument for the franchisor to monitor and exercise quality control over activities executed by the franchisee ensuring consistency (Arnestal and Fernlund [2016]). Main issues contained in the agreement are the identification of the parties, definitions, rights and obligations of both parties; intellectual property involved and its legal status; location of the franchisee and length of the contract which certain countries stipulate it cannot exceed the validity of intellectual property rights (European Commission [2020]); payments; peculiarities regarding competition law containing **trade secrets** and confidentially; training; dispute resolution including WIPO Mediation (WIPO [2019]); and choice of law where disputes will be resolved and which law should apply; and quality control and policing (Stetsiuk, Miroshnychenki and Dudko [2018]; WIPO [2019]).

Rights and obligations of a franchisor start by the obligation to grant the rights to the franchisee to operate, to provide the business format and how to operate it, including intellectual property **licences** and other relevant rights. The franchisor shall identify all intellectual property rights that the business format comprises in the franchise agreement and any other document like the operation manual. The franchisor is obliged to maintain

intellectual property rights in force and to specify whose obligation is to oversee administrative procedures and to defend these rights when they are infringed (WIPO [2016]). A franchisor shall provide the franchisee with training before and during the life of the agreement e.g., marketing, preparation or processing of goods, repairs, and general business training. If improvements are made, it must be shared with the franchisee via training or updating the operation manual.

The franchisor retains rights to supervise and control how the franchisee operates the franchise system. This is crucial for the protection of intellectual property to maintain quality and reputation of the franchise (WIPO [2016]). Additionally, any enhancement to reputation and **goodwill** of the franchise via the franchisee belongs, in principle, to the franchisor; yet this may differ between. The franchisor has the right to prohibit reproduction of the operation manual. The main benefit and right to the franchisor is the financial benefit from the franchisee.

Rights and obligations of the franchisee start by the right to use the franchisor's business system, the operation manual with the intellectual property and know-how it entails. The franchising agreement establishes obligations including the development schedule containing the number of units that will open within a time frame, if these are not fulfilled, the franchisee may lose exclusivity status or in severe cases, the agreement may terminate (WIPO [2016]). The franchisor must pay the various fees involved in franchising to the franchisee: an initial fee; royalties fees; and service fees. A franchisee shall not be involved in the same or similar business during the life of the franchise agreement (WIPO [2016]). A franchisee must permit the franchisor to inspect the franchise unit as well as the quality of goods and or service.

Other obligations included in franchising exist. Some countries ensure covenants do not conflict with national competition law; others limit in time intellectual property licenses and technology transfer, while others may prohibit automatic renewals. A few countries regulate **technology transfer agreements** by requesting that when transferring technology, and know-how, and after termination of the agreement, the franchisee can continue to use such technology and know-how, although there can be covenants regarding confidentiality.

A *breach* of provisions and covenants stipulated in the franchise agreement will lead to contractual liability. As contracts cannot include all necessary provisions, intellectual property law is available as an alternative, offering control and remedies for any incompleteness in the franchise agreement (Arnestål and Fernlund [2016]). Any infringement by the franchisee to the franchisor's intellectual property right may provide the basics for a *termination*. Unless there is a possibility to correct, the franchisee should be given the opportunity to rectify. On termination of the agreement, the franchisee must cease to use any intellectual property rights.

Some *transfers* conditions establish rights to both parties. For instance, if the franchisee dies, ownership passes to heirs. However, if the franchisor establishes that they are not capable to run the franchise, the franchisor has the right to repurchase it (WIPO [2019]). The

franchisor reserves the right to freely transfer the business to a third party while the franchisee can only transfer to a third party if the franchisee consents.

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