European IPR Helpdesk

Fact Sheet

Commercialising Intellectual Property: Franchising

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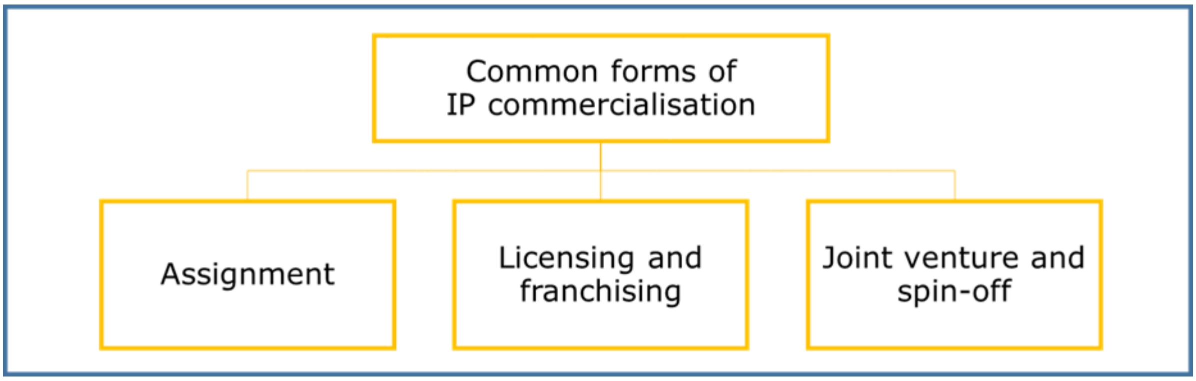
Introduction

"Commercialising IP" is a series of fact sheets aiming to provide an introduction to the forms of commercialisation that can be useful for the less advanced public likely to be involved in exploitation of intangible assets. Content provided therein is not intended to be exhaustive, and professional advice is strongly recommended when it comes to choosing the most suitable commercialisation practice for your organisation and dealing with the complex legal issues surrounding contractual arrangements. However, with these guides we aim to give you some understanding of the basic principles, which can help you save money and time.

[1] This fact sheet was initially published in December 2013 and updated in July 2015.

Commercialisation is the process of bringing intellectual property (IP) to the market in order to be exploited.

IP commercialisation can take different forms. The most common are summarised in the following diagram:



The financial success of any IP exploitation will certainly depend on the choice of the most appropriate commercialisation form, which should be based on:

- The organisation's business objectives
- The form of intellectual property
- The economic resources at its disposal

Risks should also be taken into account. Although the very nature of risks will depend on the type of commercialisation, their identification, assessment and management would give organisations more security.

The IP risks specific to commercialisation activities are those related to:

- The nature of the product and/or services
- Confidentiality
- Legal and financial matters
- Business reputation

An assessment of the risks can be based on the likelihood of the event occurrence (e.g. ownership disputes, third party infringement, etc.) and the associated consequences (e.g. irrelevant, moderate or important). Depending on the outcomes assessment, organisations will be able to make appropriate decisions about the risk management actions to be adopted (e.g. subscribing to an appropriate insurance, revising relevant clauses within contracts, etc.).

This fact sheet deals with franchising. Franchising has been increasingly used by European companies and individuals as a route for exploitation of intangibles and expansion of their business to other territories and countries[2]. This fact sheet

[2] Franchising: a Vector for Economic Growth in Europe, European Franchise Federation, 2011.

will therefore help you understand what franchising is and particularly why it is an attractive business option, whether you are a potential Franchisor or Franchisee. Moreover, you will find information on the legal environment in Europe and a checklist of the main steps to take when establishing a franchising partnership.

1. Understanding franchising

Franchising is a business model for expanding sound businesses, grounded on a business system that is replicated through the creation of a network under the same brand name.

The Franchisor is the company or person who holds the successful business concept, know-how and brand, which are (among other intellectual property) licensed for a fee to the Franchisee and continuously supported by training and on-going assistance, enabling the replication of the Franchisor's business in another location and for a determined period of time. Franchise is therefore intrinsically connected with intellectual property, since it is based on a licence of intellectual property rights and know-how.

A franchising partnership therefore encompasses the following key elements:

1. A license of intellectual property rights, particularly trade mark and copyright, as well as know-how.
2. A replication of a business concept through a strict control by the Franchisor of how the business is run and on-going training and assistance.

To regulate this business relation, the Franchisor and Franchisee conclude the so-called franchise agreement. The Franchisor and all its Franchisees together form the franchise network.

1.1 What a franchise agreement is not

Franchise agreements are a type of business partnership that shares some similarities with an agency or (exclusive) distribution arrangement. However, these are different business partnerships that should not be confused with franchising.

Agency Agreement	Distribution Agreement
• In this contract a person (the agent) is vested with the power to negotiate and/or conclude contracts on behalf of another person (the principal) for the sale of goods and/or services. • The agent receives a commission on the goods and/or services sold.	• This contract allows a manufacturer of goods (the supplier) to sell its products to a distributor, which has the goal of reselling those goods in a given territory or to a specific group of customers. • The distributor pays for the goods at an agreed price.

1.2 Why can a franchise be an added value business option?

The Franchisor and Franchisee have different roles and goals as part of a franchise. The advantages of entering into such a partnership must therefore be seen from the point of view of each partner.

On the one side, Franchisors use franchise as a way of expanding their business, with the need for less investment when compared to operating the business organically. In addition, franchise is a financially attractive option as it not only brings new capital to the business through the initial fees paid by Franchisees, but also a stream of revenue for the duration of the partnership.

On the other side, Franchisees are able to go to market more easily since the business is based on an established brand and a proven business model. This means less risks and lower costs, with higher chances of surviving the first years of business.

2. The European Code of Ethics for Franchising

In Europe the regulation of franchising is not harmonised, which means that companies and individuals in different Member States have to comply with different rules when establishing their franchising. Also, in most EU Member States there are not independent codes establishing all the rules for this particular partnership and consequently Franchisors and Franchisees must work with a patchwork of laws, adding complexity to the negotiation particularly in transnational franchises.

However, this sector has the particularity of being self-regulated in the EU through the European Code of Ethics for Franchising[3], which was first established in 1972 by the European Franchise Federation. This non-profit business

[3] The European Code of Ethics for Franchising can be found in the website of the European Franchise Federation at: http://www.eff-franchise.com/Data/Code%20of%20Ethics.pdf

association brings together several of the national franchise associations that have throughout the years been created in the EU.

The European Code of Ethics for Franchising establishes a set of guidelines and principles for both Franchisors and Franchisees, which are considered as good business practices. Even though not all European Franchisors are members of Associations and Federations at national level and consequently need not comply with the European Code of Ethics for Franchising, the Code can nevertheless help Franchisees. Indeed, the European Code of Ethics for Franchising as a standard of good practices can assist potential Franchisees evaluating Franchisors and thus to take better decisions when partnering with one.

Some EU Member States[4] have complemented the European Code of Ethics for Franchising with their own national good practices, tailored to the needs and specificities of their own franchise community and legal environment.

Therefore, it is important that potential Franchisors and Franchisees get to know the requirements that they must meet under their national law and become familiar with the European Code of Ethics for Franchising and any applicable national code. National associations for franchise in Europe can certainly help those thinking of entering in such a partnership, namely by directing them to experienced advisors that should guarantee that the franchise model follows the necessary legal requirements and fair practices established in the European Code of Ethics for Franchising.

3. Start-up checklist

3.1 Developing the system on paper

When considering expanding, most businesses should consider franchising as an option. However, not all businesses are able to be replicated with success and therefore it is essential that companies determine the feasibility of this option. Developing a feasibility study with the assistance of an expert is therefore best practice[5]. This analysis allows potential Franchisors not only in deciding to proceed with franchising, but also in planning in detail the franchising system to be launched.

At this stage it is advisable that potential Franchisors become familiar with the legal requirements of the country where the franchise will operate, including the European Code of Ethics for Franchising and any applicable national extension of the Code. It is also essential that the potential Franchisor verifies that it has the

[4] Currently these EU Member States are Belgium, France, Germany, Greece, Italy, Spain and the United Kingdom.
[5] *In Good Company: Managing Intellectual Property Issues in Franchising*, WIPO, 2012.

rights to use the intellectual property rights[6] that would be shared with future Franchisees, namely trade marks and copyright.

3.2 Testing the system in practice

It is good business practice that potential Franchisors show that their franchising system is sound by successfully operating at least one pilot unit[7] on the same or similar market before the launch of the franchising network. The pilot unit should preferably be run by the staff of the potential Franchisor or even a pilot Franchisee.

The testing of the model has several advantages. On the one side it is the best way to show to potential Franchisees that the business can be replicated and works in the way advertised. On the other side, it is the most effective way for potential Franchisors documenting the system, by developing a detailed manual of operations from the set-up to the operation stage of the franchise and fine-tuning it based on the experienced gathered during the testing.

What is the relevance of having an operations manual?

The operations manual outlines the franchise concept. Therefore it proves in practice that the idea works and helps Franchisees by supporting the business operation and transferring to them the Franchisor know-how.

3.3 Developing the franchise agreement

At the base of a franchising partnership there should be a written agreement between the Franchisor and Franchisee: the franchise agreement. It is common practice that the Franchisor drafts the agreement to be negotiated, which should be clear and fair for both parties in the deal.

In the European Union, it is best practice that the franchise agreement covers at least the following matters in accordance with the Code of Ethics[8]:

- the Franchisor rights and obligation, such as:
    - to provide assistance to the Franchisee through initial training and on-going commercial and /or technical assistance during the entire life of the partnership; and
    - to give written notice to Franchisee of contractual breaches and, where appropriate, grant reasonable time to remedy any default.

- the Franchisee rights and obligations, namely to:

[6] Clause 2.2 European Code of Ethics for Franchising.
[7] Clause 2.2 European Code of Ethics for Franchising.
[8] Clause 5 European Code of Ethics for Franchising.

- use best endeavours to the growth of the business, as well as the maintenance of the brand and its reputation;
- supply the Franchisor with verifiable operating data to facilitate the determination of performance and the financial statements;
- grant the Franchisor access to the premises and records; and
- ensure that know-how provided by the Franchisor is not disclosed to others during and after the lifetime of the partnership.

- the goods and/or services to be provided to the Franchisee;
- the financial terms of the partnership;
- the duration of the agreement (which should be long enough to allow Franchisees to amortize their initial investment);
- the terms upon which the Franchisee may sell or transfer the franchised business, as well as the Franchisor's possible right to be the first to buy it;
- the terms concerning the use of distinctive signs, such as trade marks;
- the Franchisor's right to adapt the franchise system to new or improved methods;
- the terms concerning the possible renewal and termination of the agreement;
- provisions for surrendering promptly upon termination of the franchise agreement any tangible and intangible property belonging to the Franchisor or other entity.

3.3.1 Do consider relying on alternative dispute mechanisms in case of conflicts

Franchisors and Franchisees should resolve their internal disputes in good faith through fair and reasonable communication and negotiation[9]. Relying on alternative dispute resolution mechanisms with no need for court litigation is therefore an option to consider when drafting the franchise agreement.

By introducing the possibility to use, in particular, mediation in the case of potential future disputes within the franchise agreement, Franchisors and Franchisees are able to choose a mediator with proven experience in the franchising sector, as well as in intellectual property. This can be a particularly

[9] Clause 2.4 European Code of Ethics for Franchising.

good option in transnational franchise networks. Generally, these proceedings are also much quicker and cheaper than court litigation[10].

3.4 Launching the franchise network

3.4.2 Marketing the franchise and selecting Franchisees

To launch the franchise network, potential Franchisors have to sell their franchise system. Marketing activities such as advertising campaigns and publicity materials are therefore an important part of the take-off of franchise networks. It is recommended that these promotion activities are clear and not misleading, including any references to potential expected earnings for the Franchisees[11].

Since the success of the franchise is dependent on the good work of the Franchisees, Franchisors should be careful in the recruitment process. It is best practice to develop beforehand the criteria for selection of Franchisees, which should include not only the indication of minimum financial resources, but also standards related to skills, education and personal qualities[12].

3.4.2 Sharing information

To make an informed decision when deciding to enter into the franchise agreement, potential Franchisees should have full knowledge of all information material to the franchise partnership. Hence, it is good business practice that, during the negotiations with potential Franchisees, Franchisors provide a copy of the European Code of Ethics for Franchising and information in writing on the partnership[13]. Generally, the written document under which the information is shared with the potential Franchisee is called the Franchise Disclosure document.

Examples of information included in a Franchise Disclosure document:

- the Franchisor's name and other corporate information;
- copies of the Franchisor's previous accounts;
- details on the intellectual property to be licensed, namely evidence regarding the rights over the trade marks and description of know-how;
- the franchise system;
- information on Franchisees;
- financial information to allow the evaluation of the Franchisee's total investment required.

Some countries in the European Union have specific franchise disclosure laws, which list the type of information that must be shared before the signature of the

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[10] The World Intellectual Property Organisation for example provides for specific alternative dispute resolution mechanisms in the area of franchising. For further information, please visit the following webpage: http://www.wipo.int/amc/en/center/specific-sectors/franchising/
[11] Clause 3.2 European Code of Ethics for Franchising.
[12] Clause 4 European Code of Ethics for Franchising.
[13] Clause 3.3 European Code of Ethics for Franchising.

franchise agreement. Failing to meet these disclosure commitments may have a serious impact on the partnership, including in some countries the termination of the agreement and consequent award of damages to the Franchisee. In countries where such specific laws do not exist, it is good practice to provide complete and accurate information to potential Franchisees, who should request for such disclosure.

3.4.4 Performing due diligence

Before signing the franchise agreement, potential Franchisees should gather as much information as possible on the franchise and on potential risks. It is much easier to prevent problems before they arise, which can be achieved with good research and planning.

One of the first matters to check is how sound the franchise system is. Even though a past experience is not a guarantee of future success, knowing how the franchise network has worked during previous years certainly gives a good idea of future possibilities.

The Franchisee is therefore advised to:

- Contact the national franchise association and verify whether the association provides for any training programme, as well as if the Franchisor is a member of the association.

- Read very carefully the franchise agreement and ask for professional advice (in addition to legal advice, it may be necessary to request the assistance of an accountant).

- Insist on the disclosure of information concerning commercial aspects of the deal, in case no disclosure obligations are established in the country.

- Check company details in the national register and annual reports that may be available.

- Verify the intellectual property rights to be licensed:
    - Are they protected in the territory of operation of the franchise?
    - Are the rights valid and for how long?

- Ask for the list of Franchisees (current and past) and speak to them in order to ascertain:
    - if the business is profitable;
    - any success factors;
    - the funding required to set up and have a profitable business;
    - opinion on the Franchisor training and on-going assistance;

- general experience, particularly if they have left the franchise network.

- Ask for details on the pilot unit.

- Ascertain whether the Franchisor has been involved in litigation proceedings.

3.5 Continuously train, support and monitor the franchise

One of the key characteristics of franchising is the obligation of the Franchisor to provide for training, as well as commercial and technical assistance, to the Franchisee during the lifetime of the franchise agreement[14]. This allows a good replication of the business concept, guaranteeing that consumers always have the same experience in the entire franchise network independently from the place where they are. As franchising is dependent on the experience of consumers, this consistency is of particular business importance.

Keeping quality control of the trade mark is vital from a business and legal point of view

The Franchisor as trade mark owner should ensure that the consumers are not confused by the Franchisees' use of its trade marks, to avoid risks of losing the trade mark, by guaranteeing a consistent use of the trade mark among the franchise network. This is accomplished through the implementation of quality control measures, such as:

1. the inclusion of quality control rights in the franchise agreement;
2. description of the requirements and quality standards of the Franchisee in the operations manual;
3. initial and continuous training;
4. scheduled and random visits to the premises of the Franchisee.

Useful Resources

For further information on the topic please also see:

- *In Good Company: Managing Intellectual Property Issues in Franchising*, WIPO: http://www.wipo.int/sme/en/documents/guides/in_good_company.html
- *The European Code of Ethics for Franchising*, European Franchise Federation:

  http://www.eff-franchise.com/Data/Code%20of%20Ethics.pdf

[14] Clause 2.2 European Code of Ethics for Franchising.

GET IN TOUCH

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The European IPR Helpdesk aims at raising awareness of Intellectual Property (IP) and Intellectual Property Rights (IPR) by providing information, direct advice and training on IP and IPR matters to current and potential participants of EU funded projects. In addition, the European IPR Helpdesk provides IP support to EU SMEs negotiating or concluding transnational partnership agreements, especially through the Enterprise Europe Network. All services provided are free of charge.

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Website: On our website you can find extensive information and helpful documents on different aspects of IPR and IP management, especially with regard to specific IP questions in the context of EU funded programmes.

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Training: We have designed a training catalogue consisting of nine different modules. If you are interested in planning a session with us, simply send us an email at training@iprhelpdesk.eu.

DISCLAIMER

This Fact Sheet has been initially developed under a previous edition of the European IPR Helpdesk (2011-2014). At that time the European IPR Helpdesk operated under a service contract with the European Commission.

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