**<u>WORKSHOP 10:</u> Maximising Intangible Benefits from IPRs Protection to Exploitation of IPRs. Business Strategies based on Franchising and/or Merchandising: IP Issues and Franchising**
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## What is a Franchise?

The word franchise comes for the old French word 'franchir' which means to liberate or set free. In this sense franchising offers people the freedom to own, manage and direct their own businesses.

There are largely two main types of franchise. Product distribution franchises where the trade mark and logo is licensed to the third party but the franchisee is not provided with the entire system for operating the business. Examples of product distribution franchises include soft drink distributors, car dealers and gas and petrol station. The more common type is business format franchising which is dealt with here. Business format franchising enables the franchisee to replicate, whether domestically or in different regions, the franchisors entire business concept, including marketing strategy, business and operational methods and standards. Common examples include fast food, retail, restaurants, business services and lodgings.

The rapid growth of franchising in the 1980s was due to international expansion, out of the United States, into Europe. Page 4 of the slides sets out some franchise statistics in the UK, USA and Italy. The franchise sector contributed £11.4 billion to the over all turnover in the UK in 2008.

Intellectual property rights (IPRs) are inherent to a franchise and where the term in used in a franchise agreement, it relates principally to trade marks (both registered and unregistered) copyright and know-how.

## International Franchising

The real market is in overseas growth. The international push was largely due to saturation of US markets. Overseas master franchisee will bank roll the operation whereas in the domestic market the franchisees are required to seek bank loans from its local banking systems. Slide 5 lists some of the major international franchisors.

## Definition of Franchising

In the UK there are no franchise specific laws and as such the relationship is subject to the normal rules of contract. Therefore not having a clear definition of franchising will not be too detrimental. However in the USA, Canada, Italy and Australia they do have franchise specific laws, therefore knowing whether your commercial arrangement is or is not a franchise is important. Even, within the EU, member states view the relationship between a franchisor and a franchisee differently. Some see it like any other relationship between two independent businesses and adopt a 'buyers beware' approach eg: UK and Ireland. Others view franchisees as parties in need of some form of protection eg: France, Germany and Italy. But even within these member states they have different levels of protection which are principally to do with disclosure requirements during the pre-contract stages.

The European Franchise Federation ("EFF") defines franchising as:-

> "A system of marketing goods and/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 its individual Franchisee the right, and imposes the obligation, to conduct a business in accordance with the Franchisor's concept".

This definition has been adopted by the British Franchise Association. Membership of the BFA is a benchmark by which to measure the quality of the franchise opportunity and requires the franchisor to be vetted and to adhere to a code of ethics. The BFA's Code of Ethics is based on the EFF and sets out the best practice guide for franchisors, consultants and franchisees. It requires the franchisors to (a) act fairly in dealing with its franchisee and (b) to provide detailed pre contract disclosure.

**Why Franchise?**

Franchising is a form of business expansion involving the exploitation of an intellectual property asset, where the franchisor exercises a great deal of control and offers assistance in the business.

Franchising is a key means of bringing branded products and services to the market quickly and on a global scale. It offers a cost effective means of raising capital and expanding quickly. The money, investment and skills comes from the local franchisee, who will familiar with local laws and traditions and will invariably be more motivated than a company own manager. From the franchisees perspective he will be investing in a proven brand which is easily recognisable and with a proven profit potential. Whilst he will in business on his own and have a degree of independence, franchising is often described as being in business for yourself and not by yourself.

**Is the business franchisable?**

Generally a business can be franchised so long as it can be replicated easily and generates a profit stream for the franchisee. In most countries, there is requirement for the business to be pilot tested by the franchisor to ensure that the business system has been tried out on the market and any potential pitfalls identified and ironed out.

Most businesses are franchisable except - creative businesses, these require skills which are not easily taught; technical business, with the exception of McDonalds who have an extensive training course, most franchisors have a generally short induction period; fashion production, the concept/idea must last an original term plus a renewal and low margin business. Slide 11 provides examples franchised business which include McDonalds, Burger King, Dominos Pizza, and Pizza Hut.

IPRs are inherent to a franchise. Without IPR there can be no franchise. A trade mark is the lifeblood of the franchise and is the identifier and indicator of source. It provides immediate consumer recognition and communicates a way of doing business.

**Intellectual Property Rights**

IPRs are territorial and different countries have different laws. There is a degree of international harmonisation achieved via international treaties. It is important for a franchisor to map out intellectual property exploitation ahead of the actual expansion overseas. A degree of international harmonisation is achieved by international treaties eg: for Trade Marks recourse is made to the Community Trade Mark (OHIM, Alicante) and international registrations are filed under the Madrid Protocol administered by WIPO in Geneva.

However not all IPRs have the same degree of importance to franchising. Trade marks, trade names, trade secrets (confidential information) are very important and relate to business systems, customer pricing information etc. Copyright is also important and feature in the manual and software. Design Rights may feature. Patents whilst not insignificant are also important. It is important to review the IPRs being granted and this is undertaken as part of the due diligence at the pre contract stage.

Due Diligence is no more than a process of accurately assessing the value to be acquired, value that is in relation to the tangible assets (plant and machine) and also the intangible assets (such as IPR and goodwill). These are in a constant state of flux according to the life cycle of the business, economic and political environment. In addition to undertaking the normal due diligence in acquiring a business, additional factors in franchising depend on the nature of the asset being acquired. Once the operating model and legal effect of the franchise structure has been assessed the remaining component (in determining the value of a given franchise system) is the IPRs. Prospective franchisees should obtain a list of all registered IPRs, such as trade marks, trade-names, business names and patents (if applicable). Equally important are all unregistered intellectual property rights, copyrights, trade secrets, 'secret sauce' recipes or other confidential information which form part of the target franchise model.

A prospective franchisee would want to know the nature of the licensing rights to be held, whether these are granted equally to the franchisee and whether these are capable of being modified during the term.

**Trade Mark**

A trade mark is a sign that distinguishes the goods and services of one enterprise from that of another. A definition of a trade mark is set out in Article 2 of the Trade Marks Directive (89/104/EEC). Trade marks can be protected through a system of registration, eg: in the United Kingdom registration takes place at the Trade Mark Registry and Italy at the Italian Trademarks and Patents Office in Rome. Community Trade Marks are registered in all member EU states via the Office of Harmonisation of the Internal Market (OHIM) based in Alicante, Spain. There is further international registration opportunities available via the Madrid Protocol administered by WIPO based in Geneva, Switzerland. A trade mark owner is protected by the law and where appropriate can stop a business/person making unlawful use of his trade mark, collect damages his loss or gather up the wrongdoer's profits and secure the destruction of any infringing goods. Unregistered trade marks are protected by the law of Passing Off (this is available to both registered and unregistered trade marks). However this is quite an expensive route which can serve to limit its use.

Every franchisor should develop an active trade mark protection program designed to educate its field staff, officers, employees and all of its franchisees as to the proper usage and protection of the trade mark. This is in addition to the detail trade mark obligations which are set out in the franchise agreement. More detailed guidelines for proper usage and quality are often set out in a Trade Mark Users Compliance Manual which often forms part of the operations manual. Every franchise agreement will contain a section devoted to the proper use and care of the franchisors trade marks. As a minimum it should stipulate the identity of the trade mark that the franchisor is licensing the franchisee to use; require the franchisee to use only the trade mark designated by the franchisor and in the manner authorised by the franchisor. Essentially the trade mark will be on loan during the term of the agreement to the franchisor.

The franchise agreement should provide that the franchisee is not able to licence the trade mark to a third party and not register a trade mark in its own name or that of a third party with whom it is associated. The franchisee will also be required to notify, if it learns of any improper use of a trade mark, the franchisor so that the franchisor can take any appropriate action. The franchisee will be required to expressly acknowledge that the franchisor is the owner of the trade mark and the goodwill associated with the trade mark. Any unauthorised use (infringements of the franchisors rights) may amount to grounds for termination. It is important that the franchise agreement includes such “tough” rights which can be used should the franchisee make improper use of the franchisors trade mark. Upon termination the franchisee must immediately cease use of the trade mark and or any confidential information which it has been allowed to use during the term of the franchise.

**Confidential Information and Trade Secrets**

A franchisor must consider whether its techniques, business operations, manuals, recipes, prospect list, customer lists and pricing etc can be protected as trade secrets. Trade secrets are confidential information that have commercial value by virtue of being kept secret and reasonably steps are being taken to keep them secret. Factors which are taken into account to determine if the information amounts to a trade secret include, whether information is known outside the company, whether measures been taken to safeguard its secrecy, how much money was spent in developing it, and what is the value of the information to the company if a competitor was to gain access to it.

There is no system of registration of confidential information in the United Kingdom. Trade secret protection should form part of the franchisors training program. It must educate and train its franchisees and key staff in the need to protect trade secrets. The franchise agreement will provide that disclosure of a trade secret may result in termination of the agreement and/or a claim for damages.

Protection can be achieved via the use Non Disclosure Agreements and the operations manual which should identify information which the franchisor considers to be a trade secret. A franchise agreement will contain both in term and post term provisions which deal with the protection of confidential information.

In the United Kingdom the law also protects the database rights and this also provides a degree of protection with regards to databases created by the franchisor.

**Copyright**

The law also protects the results and expressions of creative ability and in the franchising context this would include the operations manual and software program (accounting software) forms and templates. Copyright exists automatically upon the creation of a piece of work and there is no system of registration in the United Kingdom. It protects creative output, which includes literary and artistic works and includes computer software (under the Software Directive 91/250/EEC). In the United Kingdom the Copyright Design and Patents Act specifies that computer software qualifies as literary work. The owner of the Copyright information can seek injunctions to prevent further copying and claim damages. Delivery up is available. It is also possible to seek destruction of the offending items.

**Patent**

Patents protect inventions and on registrations create a monopoly right for 20 years. In the United Kingdom this is regulated by the Patents Act 1997. Novelty must be present in order to achieve protection. A level of international protection is achieved by registration at the European Patents Office (based in Munich). Once registered it can provide protection within the member states of the EU. The Patent of Co-Op Treaty enables applications in a number of countries but the actual patent is dealt with at a national level, which can provide protection for someone else using the patent whilst it is registered.

**Goodwill**

There will be goodwill which is associated with the franchisees local contracts reputation. It is often debated as to who this goodwill belongs to. Most franchise agreements provide that it belongs to the franchisor after all the franchisee has been using the franchisors trade mark, know-now system to build up its own business and goodwill. However there is an element of goodwill which is attributable to the local hard work of the franchisee which he should be able to realise on sale.

**Trade Dress**

Is an unregistered right, which made up of a combination of elements and constitutes the total image of a business. It is particularly important in for those businesses which have a retail/public presence where it is part of ‘get up and go’ of the business. Trade address includes external building features, interior design, signage, uniforms and packaging. It is designed to build brand awareness and to distinguish one company’s products or services from those of another. Protection is achieved via the operations manual and upon termination the franchisee will be required to remove all signage and alter the internal layout to ensure that there is no resemblance to that of the former franchised business.

**Conclusion**

Franchising is a form of business expansion which allows a business to expand quickly, whether domestically or internationally. The resources and management skill will emanate from the local franchisee who will be more familiar with local business and regulatory needs. IPR’s are inherent to a franchise and are of crucial importance to the success of the business. The main intellectual property rights in franchising are trade marks, copyright, know-how (confidential information). The protection of intellectual property is paramount to the survival of any business and tough measures, similar to those found in franchise agreements, are needed to prevent the misuse of IP rights.

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