

# IN GOOD COMPANY

## Managing Intellectual Property Issues in Franchising



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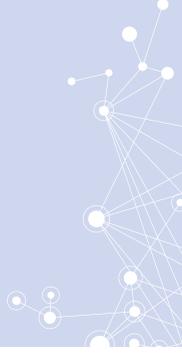




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- Pravin Anand, Partner, Anand and Anand, Noida, India
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- Luciana Bassani, Attorney, Dannemann Siemsen, Rio de Janeiro, Brazil
- Rodney de Boos, Consultant, Davies Collison and Cave, Melbourne, Australia
- Andra Filatov, Associate, Drakopolous Law Firm, Bucharest, Romania
- Sylvia Freygnier and Hubertus Thum, Freygnier Rechtsanwälte, Vienna, Austria
- Stewart Germann, Partner, Stewart Germann Law Office, Auckland, New Zealand
- Lu Ning, Akin Gump Strauss Hauer & Feld LLP, China
- Kevin B Murphy, Director of Operations, Franchise Foundations, APC, San Francisco, California, USA
- Peter Orander, Advokatfirma DLA Nordic KB, Stockholm, Sweden



- Marco Antonio Palacios, Partner, Palacios & Asociados, Guatemala
- Katen Patel, Church's Chicken, Hemel Hempstead, United Kingdom
- Jon K Peralá, Peralá Law Office, Chicago, Illinois, USA
- Tan Tee Jim, Lee & Lee, Advocates & Solicitors, Singapore
- Philip F Zeidman, Partner, DLA Piper LLP, Washington, DC, USA

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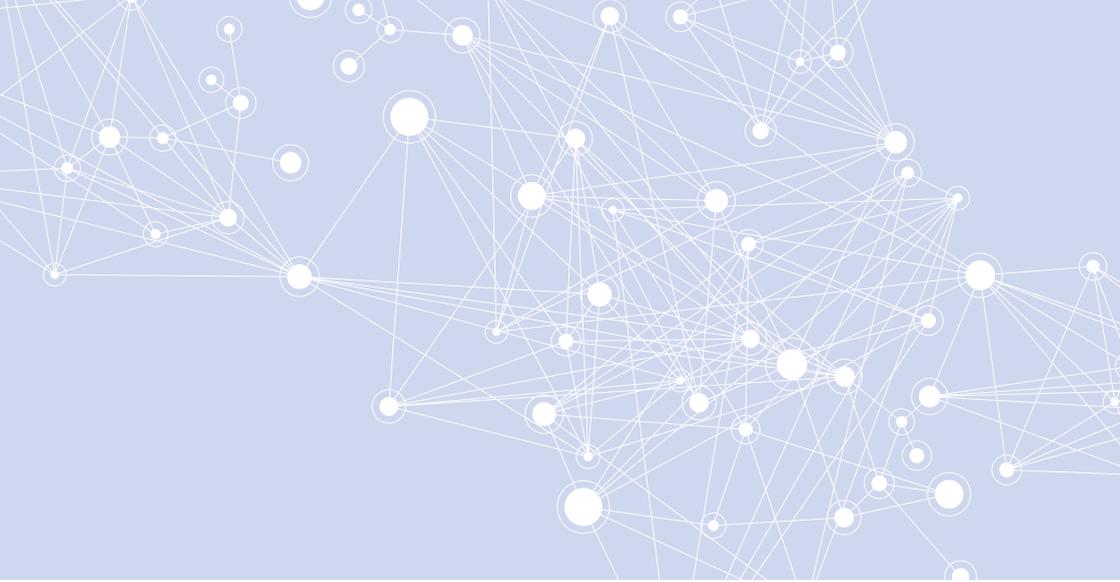


# PREFACE

Given the increasing importance of franchising as a means for business expansion, and given the critical role played by intellectual property in this regard, we believe that the publication of an internationally-focused and business-oriented guide on this topic fulfills an important need. We hope that potential franchisors and franchisees worldwide, especially those based in developing countries and least developed countries where there is little or no local experience in franchising, will find this guide an important and useful resource.

We also hope that it would be of interest to managers and other senior staff members of franchisors who need to improve their understanding of intellectual property issues. In addition, it may be of interest to students and the general public, for whom it could provide an accessible point of entry into an otherwise complex subject. To this end, we have tried to keep the language simple and easy to understand, and we have avoided as far as possible the use of jargon and technical and legal terminology.

Franchising is a complex process involving a variety of different issues, including the bringing together of a number of different parties in an interdependent chain of business units which are both independent and mutually dependent.



At the heart of franchising is the licensing of intellectual property in conjunction with a proven business model. For the franchisor, franchising enables the faster expansion of his business. For the franchisee, it provides for a better financial return with a lower risk than would otherwise have been possible without the benefit of a strong brand underpinned by a reputed trademark.

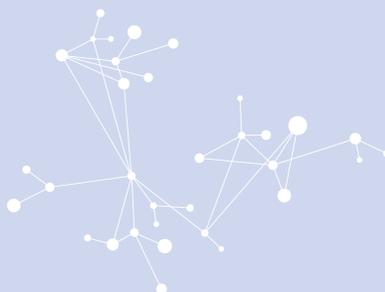
Keeping that central focus in mind, the guide takes the reader through the various phases of the franchise process: preparation; the franchise agreement; the management of a franchise, and, finally, the termination of a franchise agreement.

The importance of managing the intellectual property assets of a franchise is a core theme permeating the entire publication; in particular the guide emphasizes the importance of the brand and the various intellectual property rights that underscore, nurture and strengthen a brand.

It is hoped that this publication will serve as a useful resource for those who wish to understand more about the vital role that franchising plays in business expansion, employment creation and overall economic development. More importantly, it aims to foster both greater awareness and greater appreciation of the role played by intellectual property in that process. As such, it should also serve to highlight the importance of managing intellectual property rights to ensure the success of a franchising operation.

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# 1. INTRODUCTION

## 1.1. Different Ways of Expanding a Successful Business

A successful business that is considering expansion may choose to increase the output of its current range of products or services, or add new and improved products or services to that range. Choosing either of these options would require financial capital, which would have to be generated from within the business or from external sources. External capital may come by way of loans or by raising equity.

Other options that may be considered include entering into partnerships and alliances. Here, unlike the options outlined above, the business would have to share any rewards and risks with the partners. Depending on the interests and strategies of the business, a wide variety of alliances, relationships or partnerships may be possible, including becoming an agent, dealer, distributor, broker or trader; teaming up with an outsourced manufacturer of components; entering into a joint venture. Merger with, or acquisition of, another business is yet another option that may be considered.

Franchising is one of the fastest growing and most popular strategies for cost-effective and rapid expansion of a business, especially in cases where the business does not have or does not wish to use its own financial capital. While it draws on elements of the other business expansion strategies listed above, a franchisee is a legally separate business (which is neither a joint venture nor a legal partnership with the franchisor) that replicates the successful business operations of the franchisor in other locations. At the heart of franchising is the licensing of intellectual property.

In expanding a business to other locations (whether within the home country or abroad), all of the options listed above would have to be considered. Obviously, the process of arriving at a decision on which option, or combination of options, would be the most suitable would involve weighing up the respective pros and cons of each one. While most businesses will wish to have the same degree of control over operations abroad as they have over operations in their home country, the challenges associated with access to finance, coupled with the barriers associated with geographical distance (such as those resulting from operating in different time zones, in different business cultures and in different languages), may be further accentuated by operating in different regulatory or legal environments. In such situations, franchising may offer the best solution.

## 1.2. Franchising

Franchising is where an entity (franchisor) that has developed a particular way of doing business expands the business by giving other existing or would-be entrepreneurs (franchisees) the right to use the franchisor's proven business model in another location for a defined period of time in exchange for payment of initial and ongoing fees. Along with the right to use the business model, the franchisor permits the franchisee to use the franchisor's intellectual property and know-how and provides both initial and ongoing training and support. In essence, a successful business is replicated and run by the franchisee under the supervision and control of, and with the assistance of, the franchisor.

The permission (i.e. the license) to use the intellectual property rights associated with the franchised business is granted to the franchisee to enable the latter to successfully run a replica of the franchised business. The intellectual property rights that are licensed in a franchising arrangement almost always include trademarks and copyright, and often include trade secrets, industrial designs and patents – depending on the nature of the business. In other words, the entire spectrum of intellectual property rights.

Franchising is another way of bringing a product or service to the consumer. As long as the underlying business model is sound, almost any type of business can use franchising as a way to enter new markets in a cost-effective manner. Not all businesses are “franchisable”, however. In order for a business to be a candidate for franchising it must be capable of being replicated. In general, the following types of businesses are not considered “replicable” and are not suited to the franchise model:

- Creative businesses – those requiring particular skills, whether of an artistic or creative nature, which cannot be taught easily.
- Technical businesses – these are unlikely to be franchised because in most franchise systems only a relatively short period of initial training is provided by the franchisor. However, if the technical skills can be outsourced, as is the case in some newly emerging franchise models, this may not remain an insurmountable barrier.
- Low-margin businesses, as well as businesses that cannot sustain themselves for at least five years, or have underlying problems in their business model, do not lend themselves to franchising. Franchising will not cure underlying problems in a business; indeed, it may well exacerbate them.

For the vast majority of businesses that can be franchised, there are three main types of franchise models. They are as follows:

### **1.2.1 Product or Distribution Franchise**

A product manufactured by a franchisor (or manufactured on its behalf by another company) is sold to a franchisee who, in turn, sells it to consumers under the trademark of the franchisor. Automotive and petroleum franchises such as Ford, GM and Exxon are examples of this type of franchise model, which is usually restricted to a particular geographical area, with the franchisee paying an initial franchise fee for the right to enter the franchise network. In such franchise systems, no ongoing royalties are paid to the franchisor for the right to do business under the trademark. Instead, the franchisor derives a stream of revenue from the mark-up on sales to the franchisee.

### **1.2.2 Manufacturing, Production or Processing Franchise**

The franchisor sells the franchisee an essential ingredient, or provides some specific know-how which, along with ongoing quality controls by the franchisor, enables the franchisee to manufacture or process the final product and sell it to retailers, or in some cases, to end consumers. Coca-Cola operates in many markets throughout the world in this manner, supplying franchisees with the essential ingredient of Coca-Cola (which is protected as a trade secret), thus enabling the franchisees to produce the final product, which is then sold to retailers who, in turn, sell it to end consumers.

### 1.2.3 Business Format Franchising

The owner of a business (franchisor) licenses to another (franchisee) the right to use the particular business model, including the intellectual property rights associated with it, notably the trademark. Internationally known brands such as McDonald's, Hilton Inns and 7-Eleven are examples of companies that use this model. Because business format franchising is the most widely used model, the rest of this guide will be focused on this type of franchising. In many countries, business format franchising is the only type of franchising that is regulated.

Memory Computación, a Montevideo-based software company specializing in management and accountancy software for small and medium-sized enterprises (SMEs) relies on franchising to expand its business operations. It benefits from the franchisee's capital and knowledge of the local market, while the franchisee benefits from Memory Computación's brand reputation and know-how.



The franchisee is entitled to use the trade name, trademarks and service marks, know-how and other intellectual property rights owned by the franchisor, in exchange for agreed fees. Memory Computación has registered its trademarks in each of the countries in which it operates. For more information, see [www.solucionesmemory.com](http://www.solucionesmemory.com) ♦

Business format franchising comprises four key elements:

1. The franchisor allows the franchisee to use under license its proprietary intellectual property, principally its trademarks, but also its designs, patents, copyright<sup>1</sup> and trade secrets. The trademark is usually the most important element because it is the foundation on which the brand has been built; brand recognition is what draws customers and stimulates demand. This makes the franchise attractive to would-be franchisees. For example, if someone opened a hamburger outlet and named it "John's Hamburgers", success and annual sales would be difficult, if not impossible to predict. On the other hand, a franchise for the right to operate a "McDonald's" would be an almost guaranteed success and would generate an estimated US\$ 2.3 million in annual sales.

1 For more information on intellectual property see *What is Intellectual Property?*, WIPO Publication No. 450; *Making a Mark: An Introduction to Trademarks and Brands for Small and Medium-sized Enterprises*, WIPO Publication No. 900.1; *Looking Good: An Introduction to Industrial Designs for Small and Medium-sized Enterprises*, WIPO Publication No. 498; *Creative Expression: An Introduction to Copyright for Small and Medium-sized Enterprises*, WIPO Publication No. 918; *Inventing the Future: An Introduction to Patents for Small and Medium-sized Enterprises*, WIPO Publication No. 917.1

2. The franchisor controls the way the business is run and managed by the franchisee. Typically, this is done by providing the franchisee with a comprehensive operations manual which reinforces and provides greater detail on all areas covered during the initial training program. Field visits, “mystery shoppers” or operational audits are the most common ways for the franchisor to ensure that its “system” is being adhered to.
3. The franchisor provides training, mentoring and ongoing assistance to the franchisee.
4. The franchisee makes both initial and periodic payments to the franchisor.

In short, franchising is a special type of licensing arrangement where the right to use the business model is supported by a license to use the intellectual property rights associated with that business.

## 1.3. Different Types of Franchising Arrangements

### 1.3.1 Direct Franchising

A franchisor may enter into individual franchise agreements for each outlet (single-unit franchisee). Here, the franchisor has direct control over each franchisee and generates a revenue flow that does not have to be shared with others. However, direct franchising may not be the best option in cases where the outlets are located in another country. There may be problems including the issue of repatriating revenues, limits applicable to remittances<sup>2</sup>, tax implications, as well as difficulties related to dealing with the unique attributes of different countries, including language, culture, laws, regulations and business practices. Typically, therefore, a master franchise is the model used for international transactions.

A successful single-unit franchisee may go on to acquire more units, becoming a multi-unit franchisee.

<sup>2</sup> In certain countries, in order to facilitate the remittance of royalties, whether arising from franchise agreements or other sources, the relevant agreement must be recorded at a stipulated government institution, such as the local intellectual property office or the Central Bank.

### 1.3.2 Master Franchise Agreement

A franchisor may enter into a master franchise agreement whereby another entity is given the right to sub-franchise the franchisor's business concept within a given territory in accordance with a development timetable. These rights are usually secured by an initial development fee charged by the franchisor; the fee may range anywhere from several hundred thousand dollars to several million dollars. The grant of a master franchise enables a franchisor to expand without substantially increasing the size of its management team. Here, the franchisee, in effect, acts as the franchisor in the target country.

The disadvantage of this approach is the loss of control over sub-franchisees (with whom the franchisor has no contract), coupled with the franchisor's heavy reliance on another business entity over which it has no direct control other than through the master franchise agreement. For this reason, international franchisors, such as McDonald's and 7-Eleven, choose their master franchisees very carefully.

### 1.3.3 Area Development Agreement

An area development agreement obliges a developer to open multiple outlets (rather than appoint sub-franchisees) in a defined area over a prescribed period of time. An area development agreement has broadly the same advantages and disadvantages as a master franchise agreement; the difference is that the franchisor may, even more so than would be the case with a master franchise agreement, be putting "all its eggs in one basket" by entrusting to one business the obligation to open multiple outlets. Because an area development agreement obliges the developer to open outlets rather than appoint sub-franchisees who would take on this role, it does not involve franchising vis-à-vis the developer and the outlets; rather it involves franchising between the franchisor and the developer, who is the franchisee in this case.

### 1.4. International Franchising

Essentially, there are five ways in which a franchise system may be expanded overseas. They are as follows:

1. The franchisor, either from its headquarters or from a foreign branch operation, grants individual franchises to franchisees in the target country.
2. The franchisor establishes a subsidiary in the target country, and that subsidiary acts as the franchisor.
3. A joint venture is established between the franchisor and a third party who is knowledgeable about the target country. The joint venture will act as the franchisor in the target country.
4. The franchisor enters into a master franchise agreement.
5. The franchisor enters into an area development agreement.

In the context of internationalizing a business, it is important to bear in mind that intellectual property rights are essentially territorial, that is, the rights are limited to the territories in which they have been registered/granted or arisen. In other words, rights that exist in a certain country or region are applicable only in that country or region; this is particularly the case with trademarks, designs and patents. Therefore, if a business is planning to take a franchise operation overseas, it would be important to ensure that its intellectual property rights are protected in that territory. Before executing the franchise agreement, it would be essential for the franchisor to take steps to register its intellectual property rights in the country where the franchise business plans to operate. In addition, it would be essential for the franchisor to take similar steps in the territories surrounding that country, taking into account possible expansion strategies in the future. Some of the biggest international franchisors register their intellectual property rights either worldwide or in a number of targeted countries many years before franchising their business. A business that makes the mistake of not protecting its intellectual property rights in a target country at an early stage often discovers, to its dismay, that a smart third party has already done this and more. For example, they may have also registered certain domain names incorporating a particular trademark and, as a consequence, the business may be forced to pay them an exorbitant amount of money to buy back the rights.

## 1.5. Advantages and Disadvantages of Franchising

<b>Advantages of Franchising</b>	
<b>For the Franchisor</b>	<b>For the Franchisee</b>
Business expansion (using other people's money)	Rely on recognition of an established brand
Infusion of new capital through franchise fees	Smooth entry into a proven business model instead of starting from scratch
Additional and increasing revenue streams through royalties	Availability of training, support, know-how, marketing and financing
Franchisees perform better than employees	Established customer base
Reduced operating costs	Lower risk
Spreading of risks	Personal ownership
Smaller central organization. Less risk of management fraud	Stability, supervision and quality control
Potential buyback of successful franchises	Opportunity to grow within the system. Once successful, the franchisee can own a second unit and has the potential to become a multi-unit franchisee
	Exclusive territory
	Lower costs in purchasing inventory and equipment

<b>Disadvantages of Franchising</b>	
<b>For the Franchisor</b>	<b>For the Franchisee</b>
Risks and costs associated with seeking out and training a franchisee; supporting the launch of a new franchise operation	High start-up costs; ongoing royalty payments
A bad choice of franchisee could be disastrous for the entire franchise network	Vulnerable to the network; bad reputation of one outlet affects the whole network
Cost of maintaining the franchise network	Obligations to report and follow detailed directives and to provide access to accounting information
Confidential business information is shared, and thus becomes more vulnerable	Little flexibility due to franchisor control of business practices, inability to use knowledge gained anywhere else
Limits income to fee and royalty income and not profits	Loss of identity as customers do not know who owns the outlet
Pressure from franchisees to introduce change	Obligation to grant back to the franchisor any improvements made by the franchisee and which would be made available by the franchisor to all other franchisees

Toast sandwiches have long been a staple in Korea's road food culture. Over the past decade, Sukbong Toast has led the toast sandwich industry, transforming the traditional toast sandwich market from road food culture to in-store franchise business.



Sukbong Toast has been ranked as a “Mukyodong Top5 Specialty” and is recognized as one of the most outstanding products sold in downtown Seoul. Sukbong Toast is a registered trademark, and the method of making this unique product is a trade secret. The brand emphasizes the freshness and cleanliness of its ingredients and strives to provide the modern, health-conscious customer with the best quality sandwiches. There are more than 250 Sukbong Toast stores throughout South Korea. ♦

### Trademark rights and overseas expansion

1. Trademarks are territorial rights and are valid only in the country or region in which they are registered (unless the mark is considered well known).
2. A trademark should be protected through registration in target countries. When filing a trademark, bear in mind possible future product expansion strategies.
3. Use the six-month priority period when applying for protection abroad.
4. Use the Madrid system<sup>3</sup> for simplified international trademark filing.
5. Choose a local language mark and register all variations. Consult language specialists and be sure to select a strong mark that has resonance with the local consumers.
6. Monitor carefully for infringing marks. Carry out an exhaustive search for foreign marks that both sound and look similar to your mark, or have the same meaning. Search also for prior registered domain names.
7. Become familiar with the local trademark system. Do not assume that the trademark law in the foreign country is the same as the law in your home country. Know the pitfalls of the local system, and use lawyers that you trust. Ensure that you know the answers to questions such as: Is it a “first to file” or “first to use” country? Does the trademark office perform a relative examination? How is the system of oppositions? How long does it take before a mark is registered? Do you need to get approval for trademark assignments or licensing? ♦

3 See further, page 41

## 1.6. Franchise Associations

Franchise associations exist in most countries, and many are members of the World Franchise Council (WFC). The role of such associations is to promote the advantages of franchising and to raise awareness of franchising across stakeholders including the general public and government. While franchise associations often function as networking clubs for franchisors, the more sophisticated associations do much more than that. Activities may include:

- Promoting franchising through their websites;
- Providing educational courses;
- Advising or directing members to sources of professional advice;
- Liaising with government bodies; advancing proposals for legislative improvement, programs and strategies;
- Setting out and enforcing a code of conduct or practice for ethical franchising;
- Disciplining members;
- Providing dispute settlement mechanisms.

There are also franchisee associations or cooperatives which promote and protect the interests of the franchisees, either generally or within a specific franchise system. By operating collectively, the franchisees have greater bargaining power than if they were to interact with the franchisor independently. In addition, operating collectively is a more efficient way to communicate about issues that affect the entire franchise system.

Franchisee associations also engage in advocacy by promoting the interests of franchisees; they provide access to professional advice, and generally provide a forum for franchisees to find solutions to specific issues facing them.



Jawed Habib is one of the leading hair & beauty salon chains in India. It operates around 225 salons and training institutes in 21 states and 67 cities across India, mostly through the franchising business format. The format specifies the location, design, the number of staff, incentives, advertisement, facilities, royalties, etc. It gives potential franchisees the option of three possible variations of the business represented by three variants of its registered trademark. ♦



## 2. PREPARING TO FRANCHISE

### 2.1. Feasibility Study and Pilot Testing

When considering the franchising of a business, it is important to carry out a feasibility study as well as seek the assistance and advice of objective franchise experts<sup>4</sup>. In particular, it is important to be familiar with the relevant legal framework and to determine whether local franchise associations and franchising codes need to be taken into account. It is also important to undertake, to the extent possible, adequate pilot testing by a company-owned outlet, in order to establish the viability of the franchising concept in multiple locations as well as to document and refine business operations. The knowledge and experience gleaned during this feasibility study and pilot testing process would be used in the creation of an operations manual and training programs – the two main methods used to transfer confidential information, trade secrets and know-how to franchisees.

Pilot testing is not, however, a legal requirement and it is not universally employed. Some franchising concepts did well despite the lack of adequate pilot testing. ComputerLand, a franchise chain that expanded to over 800 locations, did not have a single store when it first began franchising its operation in the late 1970s. Essentially, ComputerLand was franchising an idea – a retail store that sold personal computer equipment. It happened to be the right idea at the right time, and the idea grew, becoming a sizeable international franchise network very quickly. Over time, of course, the market for computers changed dramatically, and the chain is now a footnote in franchise history.

<sup>4</sup> In the Republic of Korea, a person has to pass a qualifying examination in order to be considered a "franchise expert".

Another chain, iSOLD It, an eBay drop-off store, opened its one and only company-owned location in November, 2003. The idea was to provide people who wished to sell items on eBay with a retail outlet where, for a commission, items could be dropped off. Staff in the iSOLD It store were responsible for taking digital photos, listing the items on eBay, collecting the proceeds from the auction, and shipping the items to the new buyers. On 10 December 2003, a few weeks after iSOLD It opened its drop-off store, it filed an application with the California Department of Corporations to sell franchises in the United States of America. By 2006, the company had almost 200 franchised iSOLD It eBay drop-off stores in operation. However, the rapid expansion of the operation was followed by an even more rapid contraction. Many franchised operators who had made sizeable investments, including some who had mortgaged their homes and invested their retirement savings, discovered that the concept had a major flaw – it was not profitable. More than half the franchise network quickly and quietly disappeared.

Franchising a concept that has never been proven in the marketplace violates the most basic principle of franchising. In China, a franchisor must have been operating at least two company-owned outlets for one year before it is permitted to enter into franchise agreements. In the United States of America, companies with little experience or no operating prototype may enter into franchise agreements, but doing so is not recommended.

## 2.2 Disclosure

Many countries have franchise disclosure laws. The purpose of these laws is to give prospective franchisees sufficient pre-sale information about the franchise investment and contract to enable them to make the most informed decision possible.

Franchise disclosure and registration laws originated in response to worthless or nonexistent franchises being sold to investors who lost all or a substantial part of their net worth. The Minnie Pearl fried chicken franchise in the United States of America is an oft cited example. The company sold more than 2,000 franchises, less than 200 ever opened – and none survived.

In countries which do not have disclosure laws, franchisees should, as a matter of prudent business practice, only enter into binding agreements if they are armed with the full facts. Franchisors are expected to provide detailed and accurate written disclosure of all information, material to the franchise relationship, to make it more transparent to the prospective franchisees, within a reasonable time prior to executing the agreement or receiving any franchise fees. In practice, however, it appears that sufficient disclosure is generally not made, unless a franchisor is legally required to do so. Apart from providing initial disclosure information, the franchisor has a continuous disclosure requirement, including a requirement to provide a periodic (generally, annual) update of the disclosure document.

Bearing in mind that disclosure information requirements and disclosure practices may vary from country to country, the following is what is generally regarded as “full and accurate written disclosure”:

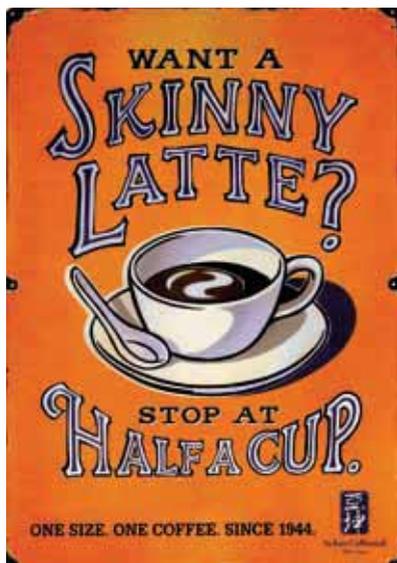
- A description of the business format (whether the franchise is being offered as single unit, multiple unit, master or area development franchise), details of the pilot operation, how long the franchisor has been in business, the people involved in the franchisor company, details of other franchisees, the franchisor’s likely competition, and any special laws that might apply to the franchised business, such as special license or permit requirements.
- Problems facing the franchisor, including whether the franchisor or any of its executive officers have been convicted of crimes involving fraud or violations of franchise law, and whether the franchisor has sued or has been sued by a franchisee during the previous year; any pending law suits that may affect the franchised business; whether a franchisee had already operated in the same general area in question, and failed; bankruptcy filings of the franchisor or its officers.
- The costs involved in starting and operating a franchise, including initial investments, deposits or franchise fees which may be non-refundable; costs for items such as inventory, signs, equipment and expenditure on advertising. Other costs which the franchisor may not have to disclose (depending on the national laws of the relevant country) include ongoing royalty fees, supply costs and insurance.
- What restrictions, if any, would apply to the franchisee, including which suppliers they must use, what goods they are not permitted to sell, and the area in which the franchisee is permitted to operate (“territory”).
- The intellectual property (trademarks, trade secrets, designs, copyright and patents) owned by the franchisor which the franchisee will be allowed to use in the franchise, including all patent expiration and trademark renewal dates, and their status in the territory to be covered by the franchise, in addition to any relevant intellectual property disputes that the franchisor may have been involved in.
- Financial statements, which should indicate the franchisor’s current financial position.
- Membership of trade and/or franchise associations.
- Grant-back provisions.
- How disputes under the agreement would be settled, and what liability would accrue for the costs of such dispute settlement.
- A copy of the current form of the franchise agreement (and, in particular, terms relating to renewal, termination and assignment).

## Ya Kun



Ya Kun has filed over 15 national trademark applications with the Intellectual Property Office of Singapore (IPOS) for its “Ya Kun” name, the “Ya Kun Kaya Toast Coffee Stall Since 1944” slogan; various posters representing the company’s history; and the names of popular products such as “Toastwich”. It has also made an international application under the Madrid system for its name and slogan. >>>

A key to Ya Kun’s intellectual property is its know-how represented in its trade secrets. The company’s coveted kaya jam recipe is a closely guarded family trade secret, and it is manufactured in a separate, family-owned facility by staff made of family members only. Mr. Loi and his family work hard to ensure that this recipe is not disclosed. Another important trade secret is Ya Kun coffee, which uses a special mix of various types of coffee beans that gives it a special aroma and flavor. >>>



Nostalgia is an important element in Ya Kun locations, so all outlets display the same posters depicting images of bygone days and the history of Ya Kun. While these posters are protected nationally through trademark applications, they, along with all of Ya Kun's manuals and other materials used in its franchise system, are also protected through copyright. Text relating to the history and profile of Ya Kun is also displayed in the company's outlets in Singapore, and thus enjoys copyright protection.

>>>

The Ya Kun franchise package gives franchisees the right to operate the Ya Kun Kaya Toast concept, use of Ya Kun's distinctive identity and trademark, initial and ongoing support, free exchange of new ideas, research and development (R&D) and marketing and public relations, in addition to being provided with a steady supply of official Ya Kun products.

A valuable intellectual property portfolio comprising trademarks, copyright and trade secrets coupled with an effective franchising system has propelled Ya Kun to international success. Ya Kun's intellectual property combines perfectly with its brand recognition to associate Ya Kun products with quality, nostalgia and a home-grown company that has wide appeal. ♦



## 2.2.1 Sample Contents of a Franchise Disclosure Document

1. Details of the franchisor and its business structure, including subsidiaries and full details of the directors together with their qualifications and business experience.
2. Business experience of the franchisor (as a company) over an extended period of time.
3. Business format being offered for the territory.
4. Disputes (arbitration awards) and litigation (judgments).
5. Details of civil or criminal proceedings against the franchisor or a franchise director.
6. Bankruptcy, or if the franchisor has been placed in administration, or has given any court-enforceable undertakings.
7. A summary of costs/payments (initial franchise fees, other fees, estimated initial investment) and the timing of such costs/payments.
8. A list of current franchisees and their contact details.
9. List of ex-franchisees (within, say, last three years); their contact details and whether the franchises were bought back, terminated, sold, etc.
10. Restrictions on the sourcing of products and services by the franchisee; details on the supply of goods and services by the franchisor or its associates to the franchisee.
11. Franchisee's other obligations and prohibitions.
12. Summary of the financing requirements.
13. Franchisor support: advertising, computer systems and training.
14. Details of the territory or franchise site, including the franchisor's territory or site selection policy and details of previous operations, if any, in those franchise locations.
15. Details of franchisor's ownership or right to use the intellectual property (trademarks, trade secrets, copyright, designs and patents) which are necessary for the successful operation of the franchise.
16. Obligation of confidentiality and non-disclosure agreement requirements, as applicable.
17. Obligation to participate in the actual operation of the franchise business.
18. Restrictions on what the franchisee may sell (goods or services).
19. Renewal, termination and transfer of the franchise agreement.
20. Dispute resolution.
21. Financial performance representations.
22. List of outlets and franchisee information.
23. Financial statements.
24. Contracts (provide the text of the proposed contracts).
25. Receipts (evidence of receipt of the disclosure document).

## 2.3 How to Market Your Franchise

The difficulties involved in recruiting franchisees should not be underestimated; recruiting the right franchisees is essential for the success of the franchised system.

It is important to understand how franchisees undertake research and select a franchise. More than three-quarters of prospective franchisees will begin the process by going through a franchisor's website; more than half will investigate other brands. These numbers are likely to rise in the future and, as a result, franchisors need to ensure that their websites are easy to find, easy to navigate, and are sufficiently encouraging to prospective franchisees. The franchisor must also ensure that its franchise offering – in terms of the initial fee, continuing fees, turnover and profitability – is not less attractive than those of its main competitors. Prospective franchisees also tend to undertake research through general franchise websites, often beginning with national franchisor associations. In addition, they may attend seminars on franchising and franchise fairs. They are, therefore, likely to be well informed about franchising and the systems that are available.

## 2.4. What Types of People become Franchisees?

While there is no such thing as a typical franchisee, the following is a list of key characteristics. They should:

- Have the support of their family;
- Be determined and hardworking;
- Have some basic business acumen (or acquire it);
- In certain cases, have sales ability;
- Have sufficient financial resources;
- Be prepared to comply with franchise system requirements.

In some countries, the law requires that the disclosure document describe the characteristics of the "ideal franchisee", such as previous relevant experience, educational background and other characteristics that the franchisee must necessarily or preferably have. By stating the requisite attributes, the franchise chain is providing guidelines for the process of recruiting the right franchisees for its business.

A profitable and franchisable business may run into trouble as a direct consequence of a hasty or deficient selection process. The prospective franchisor must develop detailed criteria for franchisee selection/recruitment; merely relying on the fact that prospective franchisees have sufficient financial resources available to them will not suffice. The franchisor must assess the prospects of developing a mutually beneficial relationship that has the capacity to evolve within the broad parameters identified in a mutually acceptable franchise agreement.

## 2.5 Due Diligence by the Franchisee

The following is the minimum list of points that a franchisee's due diligence checklist should contain:

1. Confirm the validity of the franchisor's intellectual property that is to be licensed to the franchisee. This will include verifying whether the trademarks are valid for the relevant class of goods and services; that copyright and trade secrets are being properly managed and protected; the expiration dates of any patents, designs and trademarks as well as confirmation that they are protected in the territory in which the franchisee will be operating. If there is any likelihood that the franchisee will expand its operations into another territory, care should be taken to ensure that intellectual property protection for that territory has been obtained.
2. Ask existing franchisees
  - If their business remains profitable and, if so, what are the critical factors that make it successful.
  - How long it took them to become profitable. How much funding they required in order to set up the business and reach the break-even point.
  - Their opinion of the franchisor, in terms of the quality of information provided in the operations manual; the initial assistance, training and ongoing support provided; whether they believe that the franchisor has a management team that is sufficiently experienced in the area of marketing, and in providing training and support.
3. If they had to do it all over again, would they buy this franchise, and why.
4. Contact as many franchisees as possible who have relinquished this particular system, and ascertain their reasons for doing so.
5. Ascertain whether the franchisor operated a pilot scheme before launching the franchise and, if so, how long the scheme was in operation. Determine whether the franchisor has an operations manual and also determine whether it has a formalized training and assistance program in place, and if that program is sufficient to support the operation of the franchise business. How feasible is the business – is it a viable business model? What competitors, if any, are likely to impact on the business? How long has the franchise business been in operation?
6. Determine what lawsuits, if any, the franchisor has been a party to; what types of cases and the final outcome in each case.

7. Seek the advice of an experienced franchise consultant/lawyer on both the franchise disclosure document and the franchise agreement. Seek the advice of an accountant on any financial information provided/not provided by the franchisor.
8. Determine how many franchise associations, if any, are in existence in the relevant territory, and whether the franchisor is a member. Similarly, check whether there are any franchisee associations and cooperatives in existence in the territory, because the existence of such associations and cooperatives may indicate that the franchise system has reached a certain degree of maturity.

**GOOD PRACTICES IN TRADEMARK MANAGEMENT**

## SELECTING A MARK – What should be kept in mind when selecting or creating a mark?

- Select a strong (highly distinctive) mark. Proposed marks can be classified into five categories, from most distinctive (strong) to least distinctive (weak):
  1. Coined or fanciful marks are invented words or signs without any real meaning. They are legally the *strongest* trademarks as these marks have the greatest chance for receiving registration. From a marketing perspective, they do not give the consumer any hint as to what product is being sold and greater effort may have to be put (that is, incur a higher cost) into advertising. Once established, however, these marks have enormous power. Kodak is an example of a coined/fanciful mark.
  2. Arbitrary marks are words or signs that have a meaning but the meaning has no logical relation to the product they advertise. They may also require heavy advertising to create in the minds of consumers the association between the mark and the product. But, like coined or fanciful marks, they generally receive registration. The Apple computer trademark is an example of an arbitrary mark. >>>
  3. Suggestive marks are those that hint at the nature, quality or attributes of the product, but do not actually describe these features. Such marks have a low level of distinctiveness. In some countries, a suggestive mark may be considered too descriptive of the product, and therefore may not be registrable as a mark. Since the mark describes the product, or its features, others cannot be stopped from using the same words to describe their products. For example, the mark “Sunny”, if used for marketing lamps, would hint at the fact that the product is meant to bring light into your house.
  4. Descriptive marks have little distinctiveness and accordingly are *not eligible* for protection, *unless* it can be shown that their distinctive character has been established through extensive use in the marketplace.
  5. Generic signs are totally without distinctiveness and are *not eligible* for protection as marks<sup>5</sup>. >>>

5 For further information, see the Annex on Intellectual Property Rights

- Check (do a trademark database search) to ensure that no one else has registered either the proposed mark or a mark that is confusingly similar to it.
- Avoid imitating existing marks. A slightly altered competitor's mark or a misspelled, well-known or famous mark is unlikely to be registered.
- Check that the proposed mark meets all the absolute legal requirements<sup>6</sup> for registration.
- Make sure that the mark is easy to read, write, spell and remember, and is suitable for use in all types of advertising media.
- Ensure that the mark does not have undesirable meanings or other connotations in your own language or in any of the languages of potential export markets.
- Check that the mark's corresponding domain name (i.e. Internet address) is available for registration.
- Protect figurative marks. When looking for a product, consumers generally tend to be drawn by colors and visual presentations; this is why many businesses decide to use a symbol, logo, design or shape as their mark, or in addition to a word mark. These elements may also be protected under industrial design or copyright laws. ♦

6 Ibid.

# 3. ENTERING INTO A FRANCHISE AGREEMENT

## 3.1 Laws that apply to Franchising

It is important to bear in mind that not all countries have specific legislation on franchising. A variety of legislation, including laws related to agency, employment, commercial codes, anti-trust, competition, consumer protection and trademark – as well as other intellectual property rights – may also contain provisions that are applicable. It is therefore important to review the legal framework in place, in order to clarify which laws may be applicable.

### 3.1.1 Franchise disclosure laws

Disclosure laws and registration requirements are those that apply before a franchise relationship is entered into. Some countries have disclosure laws that require information to be provided to prospective (new and renewing) franchisees before any contract is signed or any money is paid. Sometimes, as is the case in the United States of America, the disclosure requirements are extremely detailed.

In many countries, there is no legislative obligation on the franchisor to disclose specific information to the franchisee before signing a franchise agreement. In such countries, and even in countries that require disclosure, it is incumbent on the prospective franchisee to properly consider the information provided and obtain expert advice, where appropriate.

### 3.1.2 Registration requirements

A number of countries require a variety of legal arrangements to be registered. In such countries, franchisors may be required to register their disclosure documents and all exhibits (e.g. contracts, audited financial statements, list of franchise owners, and other relevant materials) with a government agency. In these countries, if registration is not completed correctly, franchisees may be prevented from operating their franchise business(es). Similarly, these laws may also require the registration of intellectual property licenses in order for them to be effective. Independently of a requirement to register the franchise agreement, some countries require specific recordal of intellectual property licenses at a government agency.

### 3.1.3 Franchise relationship laws<sup>7</sup>

Whereas franchise registration and disclosure laws are relevant for dealing with actions carried out before a franchise relationship is formed, franchise relationship laws deal with conduct after a franchise contract is signed. Such laws reflect concerns about unfair and unethical business practices by franchisors. Some of these are discussed below:

**Unjust terminations** – In general, the law requires that there should be good cause for terminating a franchise. Good cause is usually defined as failing to follow a contractual provision after receiving notice of default and not correcting (curing) the default. In the case of certain serious defaults, such as criminal conviction, abandonment and insolvency, no opportunity to correct (cure) is required to be given.

**Altering or modifying the franchise relationship** – The law prohibits a franchisor from materially modifying any existing franchise before it has filed an application with the relevant state institution and received approval. The process also requires the franchisor to give all franchisees a mini-disclosure document outlining the proposed changes.

**Renewal rights** – The franchisor must have good cause for refusing to renew a franchise; this is designed to protect franchisees from being unable to capture the benefits of the business that they have developed.

**Succession** – Some laws make provision for the surviving spouse, the heirs, or the estate of a deceased franchisee to be allowed to participate in the operation of the franchise for a reasonable period of time after the death of the franchisee. During that time, the spouse, the heirs, or the estate may either satisfy the current franchise criteria or be allowed to sell the franchise to a person who does satisfy these criteria.

**Encroachment** – Franchisees may be protected against franchisors establishing a new unit within “unreasonable proximity” of an existing franchise. If this happens, the existing franchise must be given either (a) a right of first refusal to the proposed new site, or (b) compensation for market share lost to the new unit.

**Other practices** – The following may also be regulated by franchise relationship laws: obtaining general releases from liability, or waiver of any written or verbal representations; restricting the right of free association among franchisees; discriminating among franchisees; imposing unreasonable standards of performance on franchisees. Other laws not strictly directed towards franchising may also affect the franchise relationship. For example, Australia has statutory prohibitions in relation to unconscionable conduct and misleading and deceptive conduct, which are often relied upon in franchise disputes.

7 See further Pitegoff, Thomas M and Garner, W. Michael, “Franchise Relationship Laws” in *Fundamentals of Franchising* edited by Barkoff, Rupert M and Selden, Andrew C, American Bar Association, 2008, Chapter 5.

### 3.1.4 Anti-competitive laws

Anti-competitive practices that limit, distort or prevent free competition are often prohibited by national laws (e.g. anti-trust laws in the United States of America, or unfair competition law or policy, fair trading or anti-monopoly law in many other countries). The superior bargaining power of the franchisor can be abused in many ways that may cause harm to the franchisee and, ultimately, to consumers. Franchise agreements are subject to the purview of various competition laws.

The following clauses, if included in a franchise agreement, may be considered anti-competitive:

**Resale price maintenance (RPM)** – This is a type of price fixing where the franchisor imposes a minimum resale price for goods and services supplied by the franchisor to a franchisee. The franchisor may generally recommend a resale price or impose a maximum price, but may neither require nor attempt to induce compliance with it nor set minimum prices or fixed prices. In some jurisdictions, it is mandated that where a resale price is recommended, it must be accompanied by a statement that there is no obligation to comply.

**Territorial exclusivity** – Franchisors often demarcate the areas in which the franchisees are allowed to operate; this may serve to create monopolies in that market. While in most cases, competition from substitutable products will result in preventing any adverse effect on competition, it is recommended that franchisees seek the advice of local experts.

**Exclusive dealing** – Franchisors typically require certain goods and services to be acquired by the franchisee from the franchisor or from a supplier approved by the franchisor. The franchisor has an interest in maintaining the quality of the goods or services provided by the franchisee; to that extent the franchisor may determine the suppliers to be used, as long as it is not an illegal tying arrangement (see below). A franchisee should have the right to source the required supplies from elsewhere, as long as the consent of the franchisor is obtained. The consent of the franchisor is usually contingent upon the results of the testing and evaluation of the new supplier, and is granted once satisfied that the image, quality and goodwill of the franchisor are maintained.

**Tying arrangements** – A tie is an arrangement whereby a firm makes the sale of a product conditional on the requirement that the purchaser also buys a second product which, if it were not for the requirement, it would not buy at all, or it would buy elsewhere on different terms. In a franchising context, the franchisor sells one product to the franchisee on the condition that the franchisee buys another product (goods or services) from the franchisor or its associates.

**Selling via the Internet** – This is regarded as passive selling. Usually, franchisors are not allowed to prevent their franchisees from having their own websites, as long as such websites comply with the requirement of maintaining the image of the franchise.

### Other laws

A variety of other laws, such as labor laws, tax laws, exchange control laws, insurance laws, food safety and other consumer protection laws will also have a bearing on a franchise relationship.

### 3.2 Accidental Franchise

As can be seen from the examples outlined above, a franchise may be governed by a variety of laws, notably disclosure requirements and relationship laws. These laws seek to protect the franchisee from possible abuses of power by the franchisor. They demand that the franchisor provide the prospective franchisee with adequate information on the nature of the proposed relationship well before entering into a franchise agreement. The law provides that a variety of protections are put in place; these protections cannot be circumvented or deviated from by contractual terms to the contrary. These provisions are applicable if the nature of the relationship is deemed to be a franchise relationship, even if the parties did not intend it to be (or sought to circumvent it by calling it a mere trademark license). Therefore, many relationships, such as agency, distributorship, trademark license and joint ventures, if found for all intents and purposes to be a franchise, would trigger the application of these franchise-specific laws, thus creating an “accidental franchise”.

In some countries, an “accidental franchise” is deemed to exist if, broadly speaking, there is a right to use a trademark, payment of fees and significant assistance or control by the “franchisor”. Such a situation could have important consequences. For example, if the trademark owner terminates an agreement with a distributor, and if it is determined that the relationship was in reality a franchise, the right to terminate would be dependent, by virtue of franchise relationship laws, on the concept of “just cause”. If there was no “just cause”, the termination could be considered to be illegal; pre-contractual disclosure requirements would normally not have been complied with either. Such an unintended franchise may, therefore, attract a variety of civil and criminal liabilities and penalties.

### 3.3 Franchise Agreement – Guiding Principles

Franchise agreements should strive to be balanced. However, in practice, they tend to be more favorable to franchisors. The rationale for this seems to be that the franchisor feels the need to protect its position on the basis that it is taking the bigger risk by giving another the right to use its valuable intellectual property, including confidential information and know-how.

A franchise agreement will inevitably refer to the operations manual. The manual should not override the provisions of the franchise agreement; therefore all key provisions should be included, not in the operations manual, but in the franchise agreement itself.

### 3.4 Main Provisions of a Franchise Agreement

#### 1. Parties

Identify the parties to the contract. The party granting the right is referred to as the franchisor and the party receiving the right is referred to as the franchisee.

#### 2. Definitions

The terms used in the agreement should be defined, so that each time they are used they are understood in a specific way. Defined terms should be capitalized throughout the franchise agreement.

#### 3. Rights Granted

This section should set out what exactly is being granted to the franchisee.

- It indicates whether the franchisee is an exclusive, sole, or non-exclusive franchisee.
- The territory in which the franchisee is permitted to operate, and for which territory the franchisor is not allowed to grant rights to other franchisees.
- The intellectual property rights which the franchisee has the right to use; in some jurisdictions a separate agreement for licensing the trademark(s) may be required.

#### 4. Fees

Generally, three kinds of fees are payable. The initial fee, which is an upfront, lump sum fee; it is also referred to as a franchise fee. The ongoing fees, which are royalties paid based on a percentage of gross sales. The various one-off fees may include renewal fees, advertising fees, administration fees, and so on.

#### 5. Term

The initial term of the agreement is usually (depending on the business) 5 or 10 years, with the right to renew.

#### 6. Objective Standard for Compliance with the Franchisor's System

To ensure compliance with the franchise system, the franchisor would typically have the right to inspect without notice in order to evaluate whether the franchise system standards are continuously being observed, and to identify what the franchisee must do (or not do) to ensure continuing system compliance.

#### 7. Non-agency

A clause stipulating that the franchisee is not an agent of the franchisor nor a partner or associate is intended by the franchisor to make it clear to the franchisee that it is responsible for its own liabilities.

#### 8. Franchisor's Obligations (in terms of providing guidance and assistance)

The franchisor will help the franchisee to get the business established by providing the following *initial* assistance:

- Advice on finding premises.
- Advice on equipment, fixtures and fittings in the premises.
- General advice on how to set up the franchise.
- Undertake a public relations launch.
- Provide a copy of the operations manual and system documentation.
- Provide initial training.
- Indemnify or otherwise support the franchisee in defending any third party claims of intellectual property infringement by franchisee.

- A trademark should be registered in the territory in question prior to entering into a franchising agreement. If, however, due to national legal requirements such as the inability to register a mark until it has been used in the territory, or due to other issues it has not been registered, the franchisor should take the assistance of the franchisee for the registration of the trademark (ensuring that the trademark registration is in the name of the franchisor).

The franchisor will also provide the following *continuing* assistance:

- Provide advice and guidance relating to the business.
- Supply products to the franchisee.
- Train the franchisee's personnel.
- Provide the necessary guidance and assistance to the franchisee so as to ensure that the quality of the goods and services provided by the franchisee using the franchisor's intellectual property is maintained.

### **9. Franchisee's Obligations**

Similarly, the franchisee is generally obliged to do, among others, the following:

- Lease or own a premises/site(s) for operating the franchise business. The franchisor usually requires objective/specific criteria (pertaining to location, design, layout, equipment, furniture, fixtures, signage, and so on) to be fulfilled for the premises/site to be accepted. The franchisor may retain the right to inspect and sign off the site/premises prior to the opening.
- Operate the business in accordance with the operations manual.
- Refurbish and equip the premises as required by the franchisor.
- Use only such stationery, invoices, letterheads and products that are supplied by or are approved by the franchisor.
- Purchase other products which are not supplied directly by the franchisor from authorized suppliers specified by the franchisor.
- Use in connection with the business only the signage and packaging that have been approved by the franchisor.
- Maintain the premises to the franchisor's standards and refrain from carrying out any alterations without the franchisor's consent.
- Use its best endeavors to promote and extend the business.
- Operate the business during hours specified by the franchisor.
- Ensure that staff are well dressed (if required, in uniforms), and are clean and polite.
- Not employ as a manager any person who has not completed the franchisor's training course and has not been approved by the franchisor.
- At the request of the franchisor, provide prospective franchisees with information.
- Protect the franchisor's trade secrets and other proprietary information.
- Inform the franchisor of any actual or threatened infringement of the franchisor's intellectual property by third parties.
- Inform the franchisor of any claims of infringement made by third parties against the franchisee.
- Make timely payments of fees.
- Not do anything to damage the reputation and goodwill of the franchise and the associated trademark(s).

### **10. Accounting Records**

The franchisee will be required to keep records and make regular reports to the franchisor. The franchisee may even be required to follow a certain record keeping system, which allows the franchisor to assess how different franchisees are performing. The franchisee will also be required to allow the franchisor to access and audit these records.

### **11. Advertising**

Most franchise agreements require franchisees to make a regular contribution to a separately held marketing and advertising fund which the franchisor will use for the purpose of marketing and advertising the franchise system as a whole. Franchisees may also be required to spend a minimum amount on local advertising; this is usually defined as a percentage of gross sales. If any specific advertising has to be carried out, (in relation to a particular outlet for example), then it would be subject to the approval of an advertising agency nominated by the franchisor. Alternatively, the franchisor may retain the right to review the advertising before its release, and may also retain the right to veto it. Thus, franchisees are required to use only advertising materials provided or approved by the franchisor.

### **12. Insurance**

Franchisors are usually concerned with ensuring that their franchisees are adequately insured because of the possibility of claims being made against the franchisor as a result of actions carried out by the franchisee. The franchisee will be under obligation to take out insurance for the business and to furnish the franchisor with copies of policies as well as evidence of the payment of premiums.

### **13. Sale of Business**

Usually, the franchisee has no right to transfer the franchise without the franchisor's consent; the franchisor has the right of first refusal. In other words, the franchisee must offer its business to the franchisor before it looks for another purchaser. The franchisor will have the right to approve or reject any prospective purchaser presented by the franchisee. However, if the franchisor does not wish to buy the franchise, then it must not unreasonably withhold consent, and it must agree to the transfer if the purchaser meets the franchisor's minimum standards and that the agreement has not been breached by the current franchisee. If the franchisor sells the business, the rights and obligations of the franchisor to the franchisee should accrue to the successor of the franchisor's business.

#### 14. Non-competition

In order to protect the franchise system, the franchisee is restrained from conducting a similar business both during the term of the franchise and thereafter. In practice, the franchisee is usually restrained from conducting competing businesses for a period of one to two years after either the termination or expiration of the franchise agreement. These provisions are regarded with some suspicion by the courts; it is important that the provisions are “reasonable”, in particular the restraints imposed after the termination of the franchise. If the restraints are limited in terms of time and territory, they are more likely to be considered reasonable.

#### 15. Intellectual Property

The clause granting the franchisee the right to operate the franchise will also grant the franchisee the right to use the intellectual property pertaining to the franchise. A further clause will identify the intellectual property – trademarks, designs, copyright, trade secrets and patents relevant to the franchise; it will also establish that they are owned by the franchisor or licensed to the franchisor. Safeguards will be built in to protect these rights from being infringed; such safeguards would include maintaining the confidentiality of trade secrets, and how that should be done in terms of a trade secret management program.

The franchise agreement may also require the franchisee to “grant back” to the franchisor a license to use any improvements made by the franchisee to the franchisor’s patents. As some jurisdictions will consider exclusive licenses of this nature to be anti-competitive, care must be taken to structure this clause according to the law of the territory concerned.

If a franchisee extends use of the licensed trademark into a new class of goods or services not covered by the franchisor’s existing trademark registrations, steps should be taken to extend the protection of the trademark to the new goods or services. The franchise agreement should clearly specify which party will file the application to extend protection of the mark, and which party will own the mark.

There will also be mechanisms in place as to what to do if there is third party infringement of the franchisor’s intellectual property, such as who would be responsible for taking action; what happens if the franchisor does not take action; whether the franchisee is to be indemnified if the franchisor takes no action. In certain jurisdictions, the franchisee cannot launch an infringement suit without the prior consent of the franchisor. However, an exclusive franchisee may launch an infringement suit if the franchisor, after the lapse of a certain period of time and having been notified by the franchisee, fails to take action. In all cases, a franchisee may join proceedings initiated by the franchisor, in order to seek and obtain damages for infringement.

If the franchisor's patent that has been licensed to the franchisee is found to infringe a third party's intellectual property rights, the franchisor should secure a license to use such patent rights, and extend a royalty-free license to the franchisee. The franchisor may also be required to indemnify the franchisee if the franchisee has been found liable for infringement by virtue of having used the licensed patent rights.

There may also be a clause in some jurisdictions whereby the franchisee disclaims his right to challenge the validity of the franchisor's intellectual property.

After termination or expiration of the agreement, the franchisee cannot use the trademarks of the franchisor, and will be bound to not reveal the trade secrets that were acquired during the course of the franchise.

## **16. Indemnification and Cost of Enforcement**

Virtually all franchisors make provision for indemnification. If they are sued for anything relating to the operation of the franchise by the franchisee, the franchisee is required to hold the franchisor harmless against any and all claims.

## **17. Termination**

Typically, the franchise agreement will permit the franchisor to terminate the agreement if the franchisee:

- Fails to commence business within three months (depending on the business) of execution of the agreement.
- Is in breach of specific terms of the agreement, which should be listed. The breaches that are listed as material give the franchisor the right to terminate without giving the franchisee an opportunity to cure.
- Persistently defaults in payment of any amounts due to the franchisor.
- Is found to have supplied materially false or misleading information in supporting the franchise application.
- Goes into liquidation/bankruptcy or becomes insolvent.

Following termination of the franchise agreement the franchisee:

- Should cease to use the franchisor's trademarks (including as business or domain names) and other intellectual property rights of the franchisor, and must not thereafter hold itself out as being a franchisee of the franchisor.
- Should pay to the franchisor all sums payable to the franchisor, whether or not then due.
- Should return to the franchisor all manuals, literature, promotional material, stationery, invoices or anything else, which indicates any association with the franchisor.
- Should provide the franchisor with a list of all customers and potential customers of which the franchisee is aware.
- Should not make use of or disclose any trade secrets or other confidential information relating to the system or the franchised business.
- Should not compete with the franchisor for a defined period of time.
- Should delist all telephone numbers and other contact details or pass control of and/or divert them to the franchisor or its nominee.

### 18. Choice of Law

If the franchise will be operated in a different country than the franchisor's, or is otherwise in a different jurisdiction, a choice of law provision will dictate which country's or jurisdiction's law will control the validity, performance, and interpretation of the agreements.

### 19. Dispute Resolution

In the case of disputes between the franchisor and the franchisee, the parties may select mediation or arbitration over litigation. They may first attempt to resolve the dispute by mediation and, if no resolution is reached, move on to arbitration or litigation. If arbitration is used, the franchise agreement should specify which body's arbitration rules will govern and where the arbitration will be held. The dispute resolution clause may also determine which party will pay for litigation costs and which costs will be paid. Parties may use, for example, the dispute resolution services of WIPO's Arbitration and Mediation Center. In particular, parties involved in a franchise agreement may want to include a dispute resolution clause providing for WIPO Mediation followed, in the absence of a settlement, by Expedited Arbitration when executing a contract<sup>8</sup>.

### 20. Acknowledgment

Finally, there are a series of acknowledgments by the franchisee that he or she: (a) has had ample time to review and consider the franchise investment; (b) had the opportunity to consult with financial and legal professionals; and (c) that relevant franchise disclosure timing laws, if any, have been observed.

<sup>8</sup> A recommended WIPO contract clause providing for WIPO Mediation to be followed, in the absence of a settlement, by Expedited Arbitration is available at: [www.wipo.int/amc/en/clauses/index.html#2](http://www.wipo.int/amc/en/clauses/index.html#2)

**GOOD PRACTICES IN TRADEMARK MANAGEMENT****PROTECTING THE MARK – Register the trademark**

While in many countries registration is not necessary to establish rights, it provides numerous advantages:

- **Nation-wide or region-wide (group of countries) exclusivity:** The registered owner of a mark has the exclusive right to commercially use the mark anywhere in the country/region where registration was obtained. In contrast, unregistered mark rights, where available, are limited to the part of the country where the mark is actually in use and has acquired a reputation through such use.
- **Easier to enforce:** The registration of a mark usually carries a presumption of ownership and with it the inherent right to prevent the use of that mark by others. This reduces the burden of proof in court proceedings; that is, you don't have to prove that the mark is valid, that you are its owner, that there is goodwill associated with the mark or that you have suffered monetary damages because of its use by someone else. In some countries, it also allows you to recover more monetary damages when the rights of a registered mark are infringed. >>>

- **Deterrence:** Firstly, registration enables you to use the symbol ® after the mark, which alerts others to the fact that it is registered. Secondly, a registered mark will most likely appear in the search report conducted by another business that may want to register an identical or deceptively similar mark; this will discourage the other business from doing so. Thirdly, some trademark offices will refuse to register a mark for a particular class of goods/services, which they consider to be confusingly similar to your registered mark in that same class.
- **Valuable asset:** It is simpler to sell or license a registered mark.
- **Funds:** On occasion, a registered mark with a good reputation may also be used to obtain funding from financing institutions that are increasingly aware of the importance of brands for business success.
- **Prevent importation:** Many countries have put in place systems that enable the owner of a registered mark to enlist the mark with the customs authorities for a fee. The purpose is to enable the customs authorities to inspect and seize counterfeit goods that infringe your registered mark. Unregistered marks generally do not receive such assistance from the customs authorities. ♦

### **ADVANTAGES OF USING THE MADRID SYSTEM**

The principal advantages of the Madrid system are that the trademark owner can register his mark in one or more countries which are members of the system by filing:

- **A single international application;**
- **In one language; and**
- **Subject to one set of fees and deadlines.**

Thereafter, the international registration can be maintained and renewed through a single procedure. The Madrid system thus reduces the administrative burden and costs involved in registering and maintaining marks in multiple countries.

More information on how to use the Madrid system (who can file and where, a list of members, forms, general filing information, the legal texts, on-line services, etc.) is available on the WIPO website.

See *[www.wipo.int/madrid](http://www.wipo.int/madrid)*



**POLLO CAMPERO<sup>®</sup>,**

a Guatemalan company, first opened its doors to consumers in 1971 in Guatemala City. As well as operating in more than 130 locations in Guatemala, Pollo Campero has a presence in 13 countries in the Americas, Europe and Asia. Its restaurants serve more than 80 million customers annually.

The distinguishing characteristics of the Pollo Campero franchise system include proprietary and registered trademarks; distinctive restaurant exterior and interior design, décor, color, identification schemes and furnishings; special menu items; the unique flavor of its fried or roasted chicken, which is marinated and breaded with a secret formula; standards, specifications, requirements and operations procedures; manufacturing, distribution and delivery; quality and safety of products and services offered; management systems/programs; training and assistance; marketing, advertising and promotional programs. >>>

The Pollo Campero trademark has evolved over time, from the original:



to



and then on to its current, modern format. Campero operates under the Pollo Campero trademark and various other trademarks, such as “Campero”, “Camperitos”,



“Club Campero”.

Franchisees are authorized to use the proprietary information in Pollo Campero’s Confidential Operations Manuals for the operation of the franchise. Franchisees may not, at any time, communicate or divulge any confidential information, trade secrets, knowledge, or know-how concerning the methods of operation of the franchise which Campero provides to them, including product information, sales information, customer information and merchandising systems. Franchisees may communicate this confidential information only to employees who need access to the information in order to operate the franchise. Any information, knowledge or know-how (including drawings, materials, equipment, specifications, techniques and other data which Campero marks as confidential) together with any information, knowledge or know-how that is derived from an analysis of this data is confidential, except information that is already in the public domain. ♦

## PROTECTING A FRANCHISE'S TRADE SECRETS<sup>9</sup>

- No. 1: Define the franchisor's trade secrets broadly in the franchise agreement, for example - "As used herein, the term Trade Secrets mean, any information, including, but not limited to, any manuals, contracts, customer data, supplier data, financial data, price lists, know-how, methods, techniques, processes, compilations, formulas, programs or patterns relating to the operation of the franchise and the products or services thereof."
- No. 2: Specifically state in the franchise agreement that any items embodying the franchisor's trade secrets are being licensed to the franchisee as opposed to being sold.
- No. 3: Specifically state in the franchise agreement that the franchisee is prohibited from "reverse engineering", decompiling or disassembling any items embodying the licensed trade secrets.
- No. 4: Require the franchisee to acknowledge that he or she is not violating any restrictions of any former employer or other previously-owned franchise and that he or she will not disclose or use any trade secrets of any former employer or other previously-owned franchise in the operation of the present franchise. >>>
- No. 5: Stress the importance of maintaining secrecy of the system's trade secrets and specifically include a statement in the franchise agreement wherein the franchisee acknowledges that he or she may have access to the franchisor's trade secrets and that these trade secrets have substantial value that provide the franchisee with a competitive advantage.
- No. 6: Include specific provisions in the franchise agreement that restrict unauthorized use and disclosure of the system's trade secrets and prohibit the franchisee from delivering any papers, or publishing any articles pertaining to the franchise or its activities until they are first reviewed and approved for publication by the franchisor.
- No. 7: Include specific provisions in the franchise agreement in the event of the franchisee's severance, including: requiring the immediate return of any of the franchisor's trade secret information and any items embodying those trade secrets; requiring acknowledgment that he or she has no ownership interest in the trade secrets or any items embodying the trade secrets. >>>

9 *Top Ten Ways to Help Protect Your Franchise's Trade Secrets* by Thomas Oppold, reprinted with permission of the International Franchise Association, publisher of *Franchising World* magazine.

- No. 8: Include specific guidelines in the operating manuals for protecting the secrecy of the franchisor's trade secrets, including: limiting access to the trade secrets to only those franchise employees that have a need-to-know for the performance of their duties; requiring locking of all offices, file cabinets or storage rooms in which confidential information may be found; providing appropriate legending and treatment of all trade secrets; limiting access to copying and scanning equipment and computers; and password-protecting all computers and encrypting all electronic communications containing references to the trade secrets.
- No. 9: Require the franchisee to have every employee who may have access to the franchisor's trade secrets execute an employment agreement having non-disclosure provisions, restrictive covenants, and notice requirements of subsequent employment.
- No. 10: Require the franchisee to conduct periodic meetings with the franchise employees to instruct them as to their responsibilities to maintain secrecy of the franchisor's trade secrets. The franchisee should also conduct severance interviews with any terminating employees in which they acknowledge in writing their post employment obligations to the franchise. ♦

# 4. MANAGING A FRANCHISE RELATIONSHIP

## 4.1 The Operations Manual

The operations manual is at the very heart of the franchise system and is critical for its success. As well as reinforcing training procedures, it serves as a useful reference tool. It should guide the franchisee through most of the steps involved in operating the business, and provide answers to routine questions.

In addition to dealing with specific details relating to the business or industry in question, the operations manual will generally contain the following chapter headings and content:

### 1. Introduction

- Brief summary of the franchise business
- What is expected of the franchisee
- What the franchisor will provide
- Details of the existing franchise network
- The franchisor's business philosophy
- Trademark(s) and other intellectual property to be used

### 2. System

- A detailed description of the system and each of its elements

**3. Operating Methods** – A list of what is required in order to operate the business should be set out, and could include (depending on the business):

- Equipment
- How the equipment is to be operated
- Equipment problems
- Stock requirements
- IT requirements (hardware and software)
- Vehicle requirements

**4. Operating Instructions** – All matters relating to the operation of the business should be set out in detail and should include:

- Standard forms
- Standard procedures
- Financial records
- Financial reporting
- Payment of franchise fees
- General accounting, tax matters; information on how to complete necessary forms
- Cash control and banking procedures
- How to deal with cheques, debit cards and credit cards
- Staff requirements
- Staff uniforms

- Staff training
  - Procedure for disciplining staff
  - Summary of employment legislation
  - Breakdown of job description for staff
  - Opening times
  - Trading patterns
  - Purchasing requirements and stock levels
  - Pricing policies
  - Insurance
- 5. Advertising and marketing recommendations including:**
- Local newspapers
  - Public relations companies
  - Launch procedures
  - Marketing material
  - Point-of-sale advertising
  - Local advertising policy
  - Recommendations in relation to public relations and advertising
- 6. Outlet**
- Suggested location of store
  - Store layout
  - Display and merchandising techniques
  - Cleanliness
  - Complaints procedures
- 7. Standard Forms** – All standard documentation and forms required to be used in the business should be set out. These may include:
- Business Names Act notices
  - Accounting and financial forms
  - Order forms
  - Stationery
  - Data Protection Act forms
  - Contracts of employment

**8. Legal Issues** – In countries which have detailed disclosure requirements, these requirements must be complied with. In countries which do not have such requirements, a summary of relevant legislation, licenses and permits should be provided.

**9. Franchisor's Directory**

- A list of the franchisor's employees with their job descriptions and reporting structure
- Useful telephone numbers and contact details

The operations manual should contain information on everything a franchisee needs to know in order to successfully operate the franchise. It should ensure that the essence of the franchise i.e. the business model is operated in a uniform and consistent manner by all franchisees, so that consumers have the same experience in every franchise location and the image and reputation of the franchise is consistently maintained. Every day millions of consumers go to McDonald's restaurants, not necessarily because they make the best hamburgers, but because, for the consumer, the hamburger is the same every day in every McDonald's restaurant, irrespective of geographical location. It is the consistency of experience that draws the consumer; ensuring this consistency is one of the more important tasks of the operations manual.

## 4.2 Improvements

Inevitably, during the course of the franchise, both the franchisor and the franchisee will develop improvements. The franchise agreement will require the franchisor's improvements to be implemented by the franchisees, and may also require the franchisees to pass on, assign and/or license to the franchisor any improvements that they develop.

## 4.3 Training

Initial training must be provided by the franchisor because, usually, franchisees will have no knowledge of the franchised business; in addition, the franchisor must provide continuing and ongoing training.

The initial training is usually provided "free of charge" in the sense that the cost is included as part of the initial franchise fee. Initial training consists of both classroom training and on-the-job training. Continuing training should be provided at cost and not at a profit to the franchisor, given that a well-trained franchise network is in the interests of all. Today, more and more of this training is carried out using the Internet, where learning materials including training videos and podcasts are made available to the network as a whole.



Jollibee and several variants of the mark are registered trademarks in the Philippines and many other Asian countries, and also in the United Kingdom of Great Britain and Northern Ireland, the United States of America and Europe.

Today, Jollibee Foods Corporation uses six different brands (including "Jollibee" for its core fast food business; "Greenwich" for its pizza and pasta chain, and "Chowking" for its oriental food outlets). It owns many trademarks including "Bee Happy", "Yumburger", "Chickenjoy" and "Amazing Aloha" and has registered all of its logos, some of them in several countries.

Jollibee Foods Corporation relies on a franchising model for the operation of about half of its outlets in the Philippines. In order to protect the company's high quality and service standards, potential franchisees must conform to a specific profile (self-driven entrepreneurs with good management skills, good community standing and excellent interpersonal skills).

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Successful franchising applicants undergo a three-month, full-time Operations Training Program (BOTP) at a designated training restaurant; this program is supplemented with other programs, which are designed to enrich the franchisee's management and analytical skills, and are necessary in order for the franchisee to run a successful restaurant operation.

Support for franchisees does not end there however: Jollibee also provides advice and assistance with restaurant layout and design, equipment specifications, furniture and fixtures, and construction management. Jollibee field personnel provide consulting services once the outlets are operational. Additional support to franchisees is provided in the form of creative advertising and marketing programs, product development, and manufacturing and logistics facilities. ♦

The Jollibee Word, Logo and Mascot are registered trademarks of Jollibee Foods Corporation. All rights reserved

## 4.4 Quality Control

The core of a franchise agreement is the licensing of a trademark which (together with other intellectual property rights such as trade secrets, copyright, design rights and patents) underpins a brand<sup>10</sup>. The brand is the lifeblood of the franchise. Protecting it and strengthening it is of crucial importance to both the franchisor and the franchisee; in the case of both parties, their success depends on the brand maintaining and, hopefully, strengthening its appeal.

In order to maintain its appeal, the brand must deliver on the quality and consistency of experience expected of it. A franchisor, having granted another party (the franchisee) the right to use the brand, must not and cannot divest itself of the responsibility of controlling the quality of the goods and services that are offered under the brand; it must also ensure that the entire visual and emotional experience of interacting with the brand remains consistent for the consumer. As a result, irrespective of which franchised outlet the consumer engages with, their experience of the product must be the same. The franchisor cannot divest itself of this responsibility because quality control is vital for maintaining the appeal of the franchise and the value of the goodwill associated with the brand. If quality standards fall in one franchise outlet, it will affect the whole franchise. Another reason why the franchisor cannot divest itself of this responsibility is because, as a trademark owner, it has a legal obligation to ensure that quality control is maintained by a trademark licensee (which in this case is the franchisee). If a franchisor does not continuously discharge this responsibility, then he may be deemed to have abandoned his trademark and may lose his trademark rights. Licensed trademarks which do not have proper quality control are called “naked licenses”.

10 The terms brand, trademark and mark are used interchangeably, including in this guide. However, it should be noted that brand is a marketing term, whereas trademark is a legal term. As such, these terms are not always equivalent. A key distinction between the terms becomes obvious when the value of a brand falls in a marketplace (for example following some action or statement by the owner, the company, or one of its key employees); this may succeed in tarnishing the image of the brand in the opinion of its customers. In such an eventuality, the legal position of the trademark does not change – the trademark relating to the brand continues to be a fully registered trademark on the trademark register. In other words, in terms of trademark law, the trademark continues to be just as valid and as legally protected as it was before the incident took place. The strategic management of a company's brands therefore encompasses much more than merely the management of its trademarks as legal assets. See further information on trademarks in *Making a Mark – An Introduction to Trademarks and Brands for Small and Medium-sized Enterprises*, published by WIPO and IP PANORAMA™ Module 2 at [www.wipo.int/sme/en/multimedia/flash/02/](http://www.wipo.int/sme/en/multimedia/flash/02/)

As illustrated above, the franchisor exercises considerable control over the way the franchisee operates the franchise so as to ensure that the entire franchise system adheres to certain predefined quality standards. Controlling quality begins at the point of franchisee selection, and continues throughout the lifetime of the operation of the franchise. The operations manual is the basis for the franchise operation and thus provides an objective basis for the quality standard against which the performance of the franchisee is measured. To ensure quality control, compliance with the requirements and standards set out in the operations manual must be guaranteed. Initial and on-going training, followed by regular scheduled and random visits to the franchisee's business, are important ways of ensuring that the franchise system is being followed in every respect and that the reputation of the brand remains intact.

## 4.5 Co-Branding

Co-branding is where two or more brands conduct their franchising operations under one roof. The main benefit offered by adopting this approach is that it helps to reduce expenses as a result of shared overheads and running costs, while simultaneously serving to expand the customer base. More customers are likely to visit a particular location if there is more than one brand operating there.

Typical benefits attributed to co-branding include:

- Expanding the customer base/gaining market share, thus increasing sales;
- Reducing investment and operational costs; sharing overheads; employees can be trained to do some of the work that is common to both franchisees;
- Maximizing marketing efforts and revenues generated;
- Strengthening competitive position;
- Increasing perceived value in the opinion of the consumer;
- Leveraging multiple brands.

If co-branding is not executed properly, the business owners run the serious risk of creating customer confusion, which may in turn result in dilution of the trademark. As the trademark is at the heart of the franchise, any dilution would be disastrous for the trademark owner. Some of the practical steps that may be taken to prevent this include:

1. The two businesses that are planning to co-brand should be complementary in nature; examples of complementarity would include a bookshop and a coffee shop, or a gas station and a fast food outlet. However, while the proximity of the businesses to each other may create added convenience for customers, the nature of their business should not be so similar that consumers confuse the businesses, and mistakenly believe them to be connected in some way.
2. While the two businesses may be operating under the same roof, they should be located sufficiently apart from each other. In addition, in terms of their overall appearance, this should reinforce the impression that they have separate identities. Furthermore, their respective logos and signage must be distinct.
3. Where the co-brands appear together in marketing or promotional material, the businesses should have in place a system containing design treatment details including font sizes, colors, separation distances and acknowledgements; the agreed design treatment must be complied with in order to minimize the risk of brand confusion or dilution. Finally, the co-branding agreement should make provision for ensuring that the goodwill generated by each business inures to the benefit of the respective owners.

## **GOOD PRACTICES IN TRADEMARK MANAGEMENT**

### **MAINTAINING A STRONG MARK – Dos and Don'ts for Proper Trademark Use**

Once a trademark is registered, it still needs to be maintained legally in the trademark register by paying renewal fees and its strength must be maintained in the market place by diligent use as follows:

- Use the ® symbol to denote a registered mark.
- Distinguish the mark from surrounding text by using capital letters; by putting the font in bold or italics; or by placing the text within quotation marks.
- Use the mark consistently. If the mark is registered with a specific spelling, design, color or font, make sure that it is always used exactly as it has been registered. Do not modify the mark, for example, by using hyphenation, combination or abbreviation (e.g., “Montblanc fountain pen” should not appear as “Mont Blanc”).
- Do not use the mark as a noun. Use the mark only as an adjective (e.g. say “Lego toy blocks”, not “Legos”).
- Do not use the mark as a verb (e.g. say “modified by Adobe Photoshop software”, not “photoshopped”).
- Do not use plural format for the mark (e.g. use “Tic Tac candies”, not “tic tacs”).
- Establish clear best practices and guidelines for use of the mark by employees, suppliers, distributors and consumers. Make sure the policies and guidelines are consistently followed by all concerned. ♦

## 4.6 Company, Business and Domain Names

A franchisor should give due consideration to whether franchisees will be entitled to incorporate the name of the franchise in a company name, business name, or domain name. Generally, this should be avoided, although local legal requirements might prescribe that the franchisee should register as a business name, the name under which it will be trading. In those cases, the franchisor should ensure that it controls that registration and has its own superior registration. Franchisors should also control domain names incorporating the name of the franchise if these will be used by a franchisee.

**The need to replicate all aspects of a business is well illustrated by the franchising of the Bakers Delight fresh bread business in Australia.**



The business was established in a suburb of Melbourne in 1980 by Roger and Lesley Gillespie. The early days were typified by Roger regularly having to leave dinner parties to fill in for a baker who was ill. This was a necessary consequence of the business needing to be able to have fresh bread available on a daily basis. By 1988, the Gillespies owned 15 bakeries, all of which operated on their formula for a successful and attractive bakery. Being satisfied with the formula, they began to franchise the business; by 1993 they had expanded to 200 bakeries. Today, there are over 700 bakeries, across three countries, including Canada, where the business operates under the COBS Bread brand.

The opening of a new store is now a turn-key operation. Achieving the consistency of quality in all aspects of the business, which is necessary for a successful franchise business, arises from comprehensive training of franchisees, detailed and documented procedures, ongoing operational assistance, and strong brand recognition.

So successful is the Bakers Delight model, 40 percent of its bakeries are owned by franchisees with more than one site. >>>

The importance of strong branding is vital to any successful franchise. In the case of Bakers Delight, the Gillespie's were looking for a simple brand, which conveyed to the customer a fundamental message about the business. That is, that the product sold in the Bakers Delight outlets was made by an individual baker, is made from real ingredients (hence the ear of wheat) and that the baker is proud and delighted with the product they bake.

In order to protect the brand, Bakers Delight has registered several trade marks as well as phrases in Australia and has either registered or is seeking registration of relevant marks outside Australia. Furthermore, Bakers Delight treats as confidential its recipes for its baked products as well as the processes and procedures which franchisees follow when operating a Bakers Delight outlet. These proven systems cover all aspects of running an outlet and include marketing, training, finance, purchasing and point of sale reporting systems. The franchisor also manages leases on behalf its franchisees.

In the case of Canada, the company trades under the name, COBS Bread, although the signature ear of wheat and style of the mark is copied from the Australian registered mark currently in use. In all other respects, the distinctive livery used for outlets in Australia is reproduced in Canada and other countries outside Australia. The livery takes the form of maroon on a white background (or the reverse) and extends to aprons and other items of clothing worn by staff.

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### In the words of Roger Gillespie:

"The value of our business is intimately connected to our distinctive brand and image, our product and our people. Our failure in any one of those elements impacts adversely on the others and on our value proposition overall." ♦



**COPYRIGHTED MATERIALS IN FRANCHISES  
MAY INCLUDE<sup>11</sup>:**

- Business forms (such as contracts, order forms, charts, and inspection forms).
- Training materials used to train franchisees (videos, guides, podcasts etc) or the public, if training is the core business of the franchise.
- Advertising and promotional materials (which could include material for television, print media and Internet advertising, billboards, brochures, and point of sale promotional materials).
- Franchise sales brochures.
- Original computer software created for use in the franchised business.
- Internet websites; and graphic designs, such as depictions of mascots, spokespeople, or spokesanimals (e.g., Ronald McDonald, Colonel Sanders, or the Chick-fil-A cows that encourage customers to “eat more chicken”).
- Menus, newsletters, photographs, design drawings.
- Artwork on the business’s vans, cars, or other vehicles.

11 Extract from “Copyright Protection: The Forgotten Stepchild of a Franchise Intellectual Property Portfolio” by Mark S. Vanderbroek and Jennifer M. D’angelo, *Franchise Law Journal*, Volume 28, Number 2, Fall 2008, Page 84.



## 5. END OF A FRANCHISE AGREEMENT

### 5.1 Issues that give rise to Franchising Disputes

The two guiding principles governing the resolution of franchise disputes are: first, if at all possible, franchisors should avoid adopting a heavy-handed legalistic approach; second, franchisors should not give the franchise network the impression that they are a “soft touch” and that franchisees may choose which provisions of the franchise agreement and operations manual they wish to comply with. It is not easy to reconcile these two principles.

Franchisors should not adopt a heavy-handed and legalistic approach to franchise disputes, except in the case of very serious breaches of the franchise agreement. Examples of such breaches would include where a franchisee is encouraging other franchisees to breach their franchise agreements; is disclosing confidential information; is misusing the trademarks or other intellectual property of the franchise; is intending to set up a competing business; is refusing to pay fees. In these scenarios, the franchisor’s primary obligation is to take rapid and effective action, so that the franchisee does not “get away with it” and also so

that the right message is communicated to other members of the franchise network. In cases of “non life-threatening” disputes, franchisors should try to engage in a dialogue with their franchisees and find a resolution. Ideally, this process would involve negotiation, and if that fails, mediation and, finally, arbitration. Litigation should be the last resort. The resolution of disputes would be facilitated if parties involved in franchise agreements, when executing the franchise contract<sup>12</sup>, were to include a dispute resolution clause providing for WIPO Mediation followed, in the absence of a settlement, by Expedited Arbitration.

12 A recommended WIPO contract clause providing for WIPO Mediation to be followed, in the absence of a settlement, by Expedited Arbitration is available at: [www.wipo.int/amc/en/clauses/index.html#2](http://www.wipo.int/amc/en/clauses/index.html#2)

## Common Areas of Conflict

### 1. Failure to make payments

One of the main reasons that disputes arise in franchise relationships (often called “royalty resentment”) is the failure to make royalty payments by a franchisee whose business has reached a mature stage, and who resents paying the franchisor for what is perceived to be little in return.

### 2. Site selection and encroachment

Usually, the franchisee is responsible for site selection, and the franchisor is obliged to assist in this process but, ultimately, has the right to reject the site chosen by the franchisee. The rejection of sites chosen by the franchisee has given rise to a number of disputes. Similarly, the perceived encroachment by the franchisor on the territory granted to the franchisee by opening competing franchises near the franchisee’s allocated territory has given rise to disputes. Additional practices which may be disputed by the franchisee include where the franchisor is competing with the franchisee’s business by using other means such as Internet sales or distribution of its products through other outlets in the franchisee’s territory.

### 3. Accounting practices and procedure

The franchise agreement imposes on the franchisee the responsibility to report to the franchisor a range of information from which the franchisor can judge performance, verify royalty payments, and ensure that obligations are being met. Failure to supply such information is a common ground for disputes.

### 4. Misuse of advertising funds

A common advertising fund, to which all franchisees contribute, is usually maintained in order to fund the advertising of the franchise in general. The use of this fund as a ready source of capital for other purposes by the franchisor is considered misuse, and has given rise to litigation.

### 5. Supervision and support

One of the attractive aspects of franchising as a way of doing business is the ongoing support provided by the franchisor to the franchisee throughout the duration of the franchise agreement. Conversely, failure to provide the agreed training and support often leads to litigation.

### 6. Approved suppliers

In order to maintain quality control it is standard practice for franchisors to require franchisees to purchase certain items from approved suppliers, including, in some cases, the franchisor itself. Franchisees who discover that they can buy the same things elsewhere for less may not source from alternative suppliers without the consent of the franchisor.

### **7. Raw material pricing**

Where the franchisor receives rebates from manufacturers, and does not pass these on to the franchisees, this creates disaffection. Franchisees expect economies of scale as a result of being part of a franchised system; as such, they expect to purchase raw materials at a lower price than would be the case if they purchased them on their own. This leads to conflict when franchisees believe their competitors have lower input costs.

### **8. Unequal treatment**

If benefits are offered to one franchisee they should, in general, be offered to all other franchisees in the system, unless it can be established that special circumstances warrant the benefits being offered to one particular franchisee only.

### **9. Transfers by franchisees**

If, for whatever reason, a franchisee wishes to sell the franchise, the franchisor should facilitate that process by identifying potential purchasers. Any potential purchasers suggested by the franchisee should only be rejected by the franchisor on “reasonable” grounds.

### **10. Misrepresentations by franchisor’s management team and sales team**

Litigation has followed from misrepresentations made by a franchisor’s employees to prospective franchisees in an effort to secure a franchisee. Typically, this involves inflated earnings claims or projections, or inaccurate initial investment requirements. It is, therefore, important that the franchisor’s management team and sales team are properly apprised of the dangers of overzealous efforts to secure a franchisee, and are trained accordingly. Equally, in countries which have detailed disclosure requirements, care must be taken to comply with such requirements, as the failure to do so by the franchisor could result in action being taken by both the franchisee and the regulatory authorities.

### **11. Business system changes, re-branding**

The franchisor should, as far as possible, involve franchisees in their efforts to modify the franchise business system, or to re-brand. Such activities normally involve considerable costs; therefore, franchisees should be fully involved and in agreement with the proposed changes. If re-branding also involves changing the trademark or creating a variant of it, it would have legal consequences in terms of ownership and the right to use that mark; this issue would need to be dealt with and clarified appropriately.

## 12. Intellectual property disputes

In general, disputes in relation to intellectual property will revolve around the failure by the franchisee to use the intellectual property granted by the franchisor in the prescribed manner; infringement of the intellectual property by third parties and issues as to whose obligation (and cost) it is to sue; the franchisee being sued by third parties for infringement of their intellectual property rights and the responsibility of the franchisor to join in the defense and/or indemnify the franchisee. Issues that may arise after termination of the franchise agreement include where the franchisee continues to use the intellectual property of the franchise, or discloses confidential information acquired during the franchise relationship. In a case where the franchisor attempts to prevent the franchisee from using the trademark after the termination of the franchise agreement, one of the common defenses used is that the franchisor failed to ensure that the franchisee adhere to specific quality control standards during the franchise relationship, and therefore, the franchisor has abandoned his rights in the trademark through a “naked license”. Another example of an issue that may lead to an intellectual property dispute is where, at the time the franchise was launched, the franchisor had not obtained registered rights and the franchisee registers the mark in his own name. This type of scenario is normally dealt with by a clause in the agreement requiring the franchisee to transfer the trademark to the franchisor. A variation of the above

scenario is where a franchisor operates under a specific brand but allows its franchisees to add a geographical description, such as “London” or “South West” or “UK”. In such situations, franchisees sometimes claim to have rights to the trademark and their geographical description. For this reason, giving the franchisee the option of adding descriptors to the trademark should be avoided.

The incidence of disputes and misunderstandings may be minimized if proper records are maintained. In addition, a comprehensive effort on the part of the franchisor during the process of franchisee selection may help to either prevent or minimize future problems. Appropriate franchisee selection is crucial for the success of a franchise. While there are no guarantees, the fact that the franchisor has invested the requisite amount of time and energy into the process of carrying out a thorough evaluation of the franchisees’ suitability and qualifications (experience, financial background, motivation and commitment) may help the franchisor to avoid future conflicts with their franchisees. Similarly, it is important that franchisees also carry out due diligence by seeking expert assistance and by carefully studying their potential financial obligations, so as to ensure that they can fulfill such obligations and ensure that the franchise business is financially profitable for them.

## 5.2 Contract Duration

The most common duration of a franchise agreement is either five or ten years. A small percentage of agreements are for less than five years. Franchisors such as McDonald's, Burger King, Subway and KFC grant franchises for 20 years – a timespan which tends to mirror the length of leases that franchisees commit to, and which also reflects the high start-up costs involved.

The advantage of having a five-year term is that it enables the franchisor to submit a new franchise agreement containing different terms and fees to the franchisee each time the agreement is renewed – although the introduction of different terms and fees may become a source of conflict. The existence of a five-year agreement enables the franchisor to withhold renewal if the franchisee's performance has been shown to be poor. If the contract does not grant the franchisee an automatic right to renew, it is usually easier for the franchisor to withhold the renewal than to terminate the agreement. Circumstances under which termination can take place may be governed by national laws.

In order to define a reasonable initial term, the type of business, the requirements and the investment needed to put the business in place, as well as the revenue return, should all be taken into consideration.

### 5.2.1 Conditions for Ending the Contract before Term

In franchising, maintaining the right to terminate the agreement is extremely important because, to the outside world, franchisees are the franchisor. For example, very few customers of a KFC restaurant will understand that they are not, in fact, customers of KFC but customers of another entity which has no connection with KFC other than through a franchise agreement. As a result, if a franchisee is doing something wrong, then it would be normal for franchisors to want to be able to take rapid action to avoid damage to the brand; such action may include the termination of the franchise agreement. For the franchisor, it is, therefore, very important that the franchise agreement contains the right to terminate the agreement in case the franchisee breaches certain provisions of the agreement. In general, franchise agreements do not contain a similar clause which gives the franchisee the right to terminate the agreement.

Subject to the general caveat that national laws may mandate how and under what circumstances a termination can take place, the following are some guiding principles concerning termination clauses in franchise agreements:

- The clause should be clear and unambiguous about the situations that entitle the franchisor to terminate. It should list the events that would give rise to the right to terminate. Courts in some countries generally dislike one party (especially if that party is economically more powerful than the other) having the right to terminate a long-term contract for relatively minor breaches of the franchise agreement. In the United States of America, it's all about disclosure. A 20-year franchise agreement which states that the agreement can be terminated by the franchisor if the franchisee is three days late in making any payment will be 100% enforceable as long as the franchise disclosure document had disclosed this provision of the agreement.
- Certain breaches may be so serious that they warrant immediate termination; these would include situations where a franchisee is involved in a competing business; is violating intellectual property rights; is passing on confidential information; is encouraging other franchisees to breach their franchise agreement; is deliberately under-declaring turnover. Depending on the situation, the franchisor may need to consider adopting an alternative position first, such as offering assistance to the franchisee by way of negotiation and mediation, before taking legal action that might result in termination.
- The agreement should provide a notice period and, depending on the situation, the right to cure. Finally the termination should be undertaken fairly and with courtesy.

## TRADE SECRETS MANAGEMENT

### 1. Identify Trade Secrets

- i. Technical and Scientific Information
  - a. Product Information
    - » product specifications and characteristics, proprietary recipes, compounds, formulas
  - b. Manufacturing Information
    - » production techniques, processes and technological know-how
    - » physical devices, or their service/maintenance manuals
    - » methods, techniques, processes or designs for prototypes
    - » blueprints, technical drawings, sketches, diagrams or engineering specifications

- c. Computer Technology
  - » unpublished source and object code of software
  - » software design documents
  - » algorithms, formulas, data flow charts
- d. Pending patent or utility model applications and laboratory notebooks
- e. “Negative information:” failed efforts and dead-end research
- ii. Strategy Information
  - a. Business, marketing or advertising strategies
  - b. Developed literary ideas; business methods or management routines that confer a particular advantage
  - c. Investment strategies
  - d. Market research or competitive intelligence reports
  - e. Agreements: containing details of confidential information about marketing, advertising rates, new product names or trademarks, designs or artwork for packaging, and so on
- iii. Financial Information
  - a. Cost and pricing information
  - b. Financial forecasts
  - c. Sales data and price lists
  - d. Salary and compensation plans
- iv. Commercial Information
  - a. Supplier arrangements
  - b. Agreements
  - c. Databases and electronic data compilations
  - d. Customer information
  - e. Personnel information

## 2. Take Steps to Protect them

- i. Employee-related
  - a. Awareness creation/strong enforcement of breaches
  - b. Confidentiality agreements/clauses and restrictive covenants (non-compete, non-solicitation, and non-poaching)
  - c. When hiring an employee from a competitor, ensure that misappropriation of trade secrets does not occur
  - d. Staff manual to stress the importance of trade secrets and the procedures to be followed in order to protect these secrets
  - e. Use confidentiality agreements for interactions with consultants, partners and contractors
- ii. Protection measures
  - a. Documents to be kept under lock and key
  - b. Password protection, anti-virus software, firewalls in computers
  - c. Disclosure on a “need to know” basis
  - d. Security marking on documents: “confidential”, “make no copies” and so on
  - e. Care to be taken in the use of mobile devices (e.g. laptop computers, phones, USB sticks)
  - f. Restriction of access; registration at reception desk/visitor logs/escorts; “keep out”, “authorized personnel only” signs, access cards
  - g. Access-controlled photocopiers, scanners, computers. Preference for use of shredders, as opposed to using waste bins
  - h. Control measures for uploading information to the Internet

### 5.2.2 Contract Renewal

There is a general expectation that, in addition to the base term, a franchisee is guaranteed at least fifteen or twenty years for operating the franchise (assuming the renewal conditions are satisfied). In the case of a resale (assignment from one franchisee to a new franchisee), the incoming franchisee should have a “guaranteed” period of time in which to operate the franchise; it should be equivalent to the time period that would be offered to a new franchisee rather than the remaining operating time of the original franchisee.

The conditions of a renewal clause may include the following:

- The franchisee must give notice to the franchisor of his wish to renew, usually a notice period of between three to nine months before the expiry of the term. The exact notice period would be linked to the length of time it would take a franchisor to replace a franchisee if the franchisee did not wish to renew the franchise agreement.
- The franchisee should not have committed any serious breaches, should generally have complied with the agreement and should not be in breach of the agreement at the time he serves notice of renewal or at the time when renewal occurs. Franchise agreements should avoid clauses that take away from the franchisee the right to renew in situations where minor or trivial breaches of contract have occurred; it is inevitable that minor breaches of a franchise agreement will occur.
- The franchisee must renounce claims against the franchisor. The reason for such a clause is that franchisors do not want to worry about future litigation related to events that took place during the lifetime of the “old” agreement; both parties must start fresh. In this clause, the franchisor is essentially saying: “You may have been granted a renewal, but you may not sue me under the old contract.” This clause is now standard in many franchise agreements.
- The franchisee must take all necessary steps to ensure that the franchise operation meets the standards specified by the franchisor – the franchisor could have rebranded or imposed additional equipment requirements on franchisees since granting the franchise to the renewing franchisee.
- The franchisee may be required to pay a renewal fee. Given that a franchisor’s primary aim is to retain within the franchise system a franchisee who is performing well, renewal fees, if any, should be minimized and should be aimed principally at reimbursing the legal, administrative and management costs incurred by the franchisor in the issuing of a new franchise agreement.

- The franchisee may lose the right to renew if performance has been poor. While substantial doubts exist about the desirability of applying minimum performance requirements during the term of the agreement (and in some countries they are not used), the inclusion of a minimum performance requirement clause in a renewal agreement is an entirely different matter. Franchisors should consider including a provision which states that they are not obliged to renew if a franchisee's performance has been in the bottom 10% although this only works if franchisees' territories or catchment areas are broadly comparable.
- The franchisee will be required to enter into the franchisor's current franchise agreement. Most franchise agreements give the franchisor a free hand with regard to the terms of the renewal agreement; this is because the franchisor does not know how his franchise will develop, or what changes in legislation will take place. This is a difficult area: can a franchisor make radical changes to the franchise on renewal, so that, for example, the management service fee increases from 5% to 15%? The answer will depend on the laws and practices of different countries.

### 5.3 Transfer Conditions

The franchisor will usually provide in the franchise agreement that he can freely transfer his business and/or the franchise agreement to a third party. The franchisee, on the other hand, may only transfer his business to a person who the franchisor wishes to accept as a franchisee, and who conforms to the franchisor's selection criteria. In addition, the franchise agreement usually contains a provision which gives the franchisor the right of first refusal to purchase the franchise business, should the franchisee wish to sell the franchise business or assign the franchisee agreement. Equally important is the requirement that the new buyer successfully complete the franchisor's training program to the satisfaction of the franchisor.

## 5.4 Dispute Resolution

As with any relationship, business or otherwise, things can go wrong. It is, therefore, reasonable and common sense to give consideration to the possibility of issues arising which could destroy an otherwise healthy relationship. This advice holds true for all business relationships but it is particularly important in the context of franchising, where a long-term relationship is envisaged – one which involves regular and close interaction between the franchisor and the franchisee. Anticipating problems is often one of the best ways to prevent them from occurring. If, however, despite best efforts, disputes do arise, managing these disputes and resolving them becomes crucial for the long-term health of the franchise.

Going into litigation for breach of any of the provisions of the franchise agreement is always an option available to both the franchisor and the franchisee, and may in some cases be the preferred means of resolving a dispute. However, given the complexity of the process involved in taking court proceedings, coupled with the expense and the time required, it may be wise to seek an alternative means of settling a dispute. The most common methods are mediation and arbitration, which are widely regarded as less time consuming and, in the case of mediation, less expensive. In particular, if the franchisor and franchisee are located in different countries, arbitration is the preferred method of dispute settlement.

The agreement should normally provide for the possibility of resorting to mediation and/or arbitration which, in some countries, is required by legislation. Compared with mediation, arbitration is similar to litigation in that a formal decision is delivered by the arbitrator and this decision is normally enforceable. Mediation, on the other hand, is less formal. The parties select by consensus a mediator whose job it is to facilitate the settlement of the dispute by enabling the parties to come to a mutually acceptable agreement. The mediator thus has no authority to decide a case as such; his authority is limited to enabling the parties to reach a solution that is acceptable to both sides. During the mediation process, the parties have the opportunity to present their respective positions to the mediator in the presence of each other, and privately to the mediator; all such private discussions are deemed confidential. Usually, before either of these methods of dispute resolution is embarked upon, the parties are advised to try to settle their disputes in an informal way, ideally through face-to-face discussions.

## **WIPO ARBITRATION AND MEDIATION CENTER DISPUTE RESOLUTION SERVICES**

The WIPO Arbitration and Mediation Center (WIPO Center) is a recognized neutral and international dispute resolution provider. It administers, on a non-profit fee basis, alternative dispute resolution procedures, such as mediation, arbitration and expedited arbitration under the WIPO Mediation, Arbitration and Expedited Arbitration Rules.

The WIPO Center caseload includes intellectual property and other commercial disputes, such as licensing and distribution disputes, trademark licenses and coexistence agreements, royalties, exclusivity and termination issues. The WIPO Center has a list of over 1,500 mediators and arbitrators from all over the world, including franchising specialists who can be appointed by parties in WIPO proceedings.

The WIPO Center provides recommended contract clauses which can be used in franchising agreements, and offers an established case management infrastructure through which experienced multilingual legal case administrators are assigned to mediations and (expedited) arbitration proceedings. The case administrator assists the parties in the mediation and arbitration process, helps with the appointment of the mediator and the arbitrator(s), facilitates communication, manages finances, and can also provide logistical assistance. Parties in WIPO cases may choose to use the WIPO Electronic Case Facility (WIPO ECAF) which allows them and all other actors in a case to file submissions electronically in order to facilitate communication. In all respects, the WIPO Center has a strong commitment to procedural efficiency.

WIPO mediations tend to settle in more than 70% of cases. A significant proportion (approximately 60%) of WIPO arbitration cases also result in settlement.

The WIPO Rules and clauses, together with other resources, may be accessed online at [www.wipo.int/amc/](http://www.wipo.int/amc/).

## 5.5 Post-termination Issues

Following the termination of a franchise agreement, the franchisor will be concerned about the impact of the termination on goodwill, and the risk that the ex-franchisee will make use of the trademark, trade secrets and other confidential information, and any know-how acquired during his time as a franchisee. Such concerns are addressed by provisions that protect the trademark and the brand image; they are also addressed by what are known as non-compete covenants, which restrict the ex-franchisee from engaging in a competing business.

Thus, in order to protect the goodwill, the ex-franchisee will be obliged to take one or more of the following steps<sup>13</sup>:

- Cancel any registration of the license granted by the franchisor for the use of his trademark.
- Change the signage and the décor of the premises, as well as the signage on any vehicles.
- Return all advertising, packaging, marketing and promotional materials associated with the franchise.
- Cease using stationery, literature and websites bearing the franchisor's trademarks, service marks, trade names, domain names and other references to the franchise.
- Return all operations manuals.
- Cease using the franchisor's system.
- Cease using the franchisor's copyrighted material.

The franchisor may have reserved the right to buy the tangible assets of the business based on a pre-determined formula (such as depreciated cost), and/or to take over the lease on the business premises. If this happens, the franchisee is literally out of business. Many franchisors exercise these rights, and then sell the location to a new buyer as a "turn key" franchise.

Non-compete covenants, preventing the ex-franchisee from being involved in a competing business, are considered restraints of trade and are enforceable only if they are "reasonable". In determining whether they are reasonable, the following three factors are considered:

- **The duration (time) of the restraint:** In general, one year is a recommended maximum.
- **The scope of restricted activity:** Certain jurisdictions have laws that contain specific norms regulating this matter; therefore, it is important to review local legislation. The restriction should be confined to the scope of the franchised activity. For example, if the franchisee operated a burger restaurant, a non-compete which applied to "any food operation" is likely to be held invalid as overbroad.
- **The geographical area where the restraint applies:** Limit the non-compete area to the territory specified in the franchise agreement or, if no specific territory is defined, to the "customer area" of the franchisee's business. Therefore, if 80% of the franchisee's customers live within five kilometers of the franchised premises, it would be unwise to extend the covenant any further.

13 "Termination of the Franchise Relationship" at [www.whichfranchise.co.za/article.cfm?articleID=40](http://www.whichfranchise.co.za/article.cfm?articleID=40) [accessed on October 4, 2010]

## 5.6 Class Actions

Often, a single franchisee may find it daunting to take on a franchisor in a legal battle on its own. By joining forces, franchisees who are “similarly situated” may bring a class action against a franchisor on behalf of a group of franchisees. In jurisdictions where class actions are not common, franchisees with similar legal issues may join in an ordinary action. Franchisors have sought to protect themselves from such an eventuality by including in the agreement a clause where the franchisee promises in any future litigation or arbitration to litigate only their own claims, and not the claims of any other party.

# ANNEX

## INTELLECTUAL PROPERTY RIGHTS<sup>14</sup>

Intellectual property refers to creations of the mind: inventions; literary and artistic works; symbols; names, and images used in commerce. It is divided into two categories: industrial property and copyright.

Industrial property includes patents for inventions; trademarks; industrial designs and geographical indications. Copyright includes literary works such as novels, poems and plays; films; musical works; artistic works such as drawings, paintings, photographs and sculptures; architectural designs. Rights related to copyright include those of performing artists in their performances, producers of phonograms, and those of broadcasters in their radio and television programs.

While the intellectual property laws of most countries are moving towards greater harmonization, these laws remain national (or regional, depending on whether a group of countries has agreed to such a regional intellectual property law), and have effect only within the territorial boundaries of a particular country or region. Consequently, an intellectual property right obtained within a particular jurisdiction is valid in that jurisdiction only.

### Trademarks

A trademark is a distinctive sign which identifies certain goods or services as those produced or provided by a specific person or enterprise. The trademark system helps consumers identify and purchase a product or service because the nature and quality of that product or service, as indicated by its unique trademark, meets their needs.

14 Extract from What is Intellectual Property?  
WIPO Publication Number 450 (E)  
ISBN 978-92-805-1155-0 except section  
on Trade Secrets which is an extract  
from Secrets of Intellectual Property, A  
Guide for Small and Medium-Sized  
Exporters published by the International  
Trade Centre and the World Intellectual  
Property Organization, Geneva 2004.

A trademark provides protection to the owner of the mark by ensuring the exclusive right to use it to identify goods or services, or to authorize another to use it in return for payment. The period of protection varies, but a trademark can be renewed indefinitely on payment of corresponding fees and subject to its continued use. Trademark protection is enforced by the courts, which in most systems have the authority to block trademark infringement.

Trademarks may be one or a combination of words, letters and numerals. They may include drawings, symbols, three-dimensional signs such as the shape and packaging of goods, and in some cases even audible signs such as music or vocal sounds, fragrances, or colors used as distinguishing features. In addition to trademarks identifying the commercial source of goods or services, other categories of marks exist. Collective marks are owned by an association whose members use them to identify themselves with a level of quality and other requirements set by the association. Examples of such associations would be those representing accountants, engineers, or architects. Certification marks are given for compliance with defined standards, but are not confined to any membership. They may be granted to anyone who can certify that the products involved meet certain established standards. The internationally accepted "ISO 9000" quality standards are an example of such widely recognized certifications.

Legal protection for a mark is obtained through registration and, in some countries, through use. Registration is obtained by filing the appropriate application form at the national or regional trademark office. Applications for trademark registration are usually rejected on what are referred to as "absolute grounds" in the following cases:

- Generic terms – For example, one could not register the trademark CHAIR to sell chairs. The mark would be rejected since "chair" is the generic term for the product.
- Descriptive terms – These are words that are usually used in trade to describe the product in question. For example, the mark SWEET is likely to be rejected for marketing chocolates as being descriptive. Similarly, qualitative or laudatory terms such as RAPID, BEST, CLASSIC or INNOVATIVE are likely to give rise to similar objections unless they are part of an otherwise distinctive mark.
- Deceptive trademarks – These are trademarks that are likely to deceive or mislead consumers as to the nature, quality or geographical origin of the product. For example, marketing margarine under a trademark featuring a COW would probably be rejected, as it would be considered misleading for consumers who are likely to associate the mark with dairy products (i.e. butter).
- Marks considered to be contrary to public order or morality – Words and illustrations that are considered to violate commonly accepted norms of morality and religion are generally not allowed to be registered as trademarks.

- Flags, armorial bearings, official hallmarks and emblems of states and international organizations which have been communicated to the International Bureau of WIPO are usually excluded from registration.

Applications are rejected on “relative grounds” when the mark conflicts with prior trademark rights, that is, previously registered identical or similar marks for the same or similar type of product.

For more information, see *Making a Mark: An Introduction to Trademarks and Brands for Small and Medium-sized Enterprises*, WIPO publication No. 900.1 and IP PANORAMA™ multi-media toolkit Module 02 and 12 at [www.wipo.int/sme/en/multimedia/](http://www.wipo.int/sme/en/multimedia/).

## Trade Secrets

Broadly speaking, any confidential business information that provides an enterprise with a competitive edge can qualify as a trade secret. A trade secret may relate to technical matters, such as the composition or design of a product, a method of manufacture or the know-how<sup>15</sup> necessary to perform a particular operation. Common items which are protected as trade secrets include manufacturing processes, market research results, consumer profiles, lists of suppliers and clients, price lists, financial information, business plans, business strategies, advertising strategies, marketing plans, sales plans and methods, distribution methods, designs, drawings, architectural plans, blueprints and maps.

While conditions vary from country to country, in order to qualify as a trade secret, some general standards exist. They are that the information must be confidential or secret. Information which is generally known or readily ascertainable is not protectable as a trade secret. Even hard-to-learn information can lose its protected status if the owner does not take proper precautions to maintain its confidentiality or secrecy. The information must have commercial value because it is a secret and the holder of the information must have taken reasonable steps to keep it confidential or secret (e.g. through confidentiality or non-disclosure agreements with all those who have access to the secret information. Simply calling information a trade secret will not make it so).

15 Know-how may or may not be a trade secret. Know-how generally refers to a broader group of internal business knowledge and skills which would amount to a trade secret if the conditions for qualifying as a trade secret have been met.

The owner of a trade secret can prevent others from improperly acquiring, disclosing or using it. However, trade secret law does not give the right to stop people who acquire or use information in a legitimate way, that is, without using illegal means or violating agreements or state laws.

Unlike other forms of intellectual property such as patents, trademarks, and designs, maintaining trade secrecy is basically a do-it-yourself form of protection. Trade secret protection lasts for as long as the information is kept confidential. Once the relevant information is made public, trade secret protection comes to an end.

For more information, see *In Confidence: An Introduction to Trade Secrets for Small and Medium-sized Enterprises*, WIPO publication No. 929 (forthcoming) and IP PANORAMA™ multi-media toolkit Module 04 at [www.wipo.int/sme/en/multimedia/](http://www.wipo.int/sme/en/multimedia/).

## Copyright and Related Rights

Copyright is the body of laws which grants authors, artists and other creators protection for their literary and artistic creations, which are generally referred to as “works”. A closely-associated field of rights related to copyright is “related rights”, which provides rights similar or identical to those of copyright, although sometimes more limited and of shorter duration. The beneficiaries of related rights are performers (such as actors and musicians) in their performances; producers of sound recordings (for example, cassette recordings and compact discs) in their recordings; and broadcasting organizations in their radio and television programs. Works covered by copyright include, but are not limited to: novels, poems, plays, reference works, newspapers, computer programs, databases, films, musical compositions, choreography, paintings, drawings, photographs, sculpture, architecture, advertisements, maps, and technical drawings.

The creators of works protected by copyright, and their heirs and successors (generally referred to as “rights holders”), have certain basic rights under copyright law. They hold the exclusive right to use or authorize others to use the work on agreed terms. The rights holder(s) of a work can prohibit or authorize its reproduction in all forms, including printing and sound recording; its public performance and communication to the public; its broadcasting; its translation into other languages; and its adaptation, such as a novel into a screenplay for a film. Similar rights of, among others, fixation (recording) and reproduction are granted under related rights.

Many types of works protected under the laws of copyright and related rights require mass distribution, communication and financial investment for their successful dissemination (for example, publications, sound recordings, and films). For this reason, creators often transfer the rights to their works to companies which are best able to develop and market the works, in return for compensation in the form of payments and/or royalties (compensation based on a percentage of revenues generated by the work).

The economic rights of copyright have a duration, as provided for in the relevant WIPO treaties, commencing upon the creation and fixation of the work, and lasting for not less than 50 years after the creator's death. National laws may establish longer terms of protection. This term of protection enables both creators and their heirs and successors to benefit financially for a reasonable period of time. Related rights enjoy shorter terms, normally 50 years after the performance, recording or broadcast took place.

Copyright and the protection of performers also include moral rights, which are the right to claim authorship of a work, and the right to oppose changes to the work which could harm the creator's reputation.

Copyright and related rights protection is obtained automatically without any need for registration or other formalities. However, many countries provide for a national system of optional registration and deposit of works; these systems facilitate, for example, questions involving disputes over ownership or creation, financing transactions, sales, assignments and transfers of rights. Many authors and performers do not have the ability nor the means to pursue the legal and administrative enforcement of copyright and related rights, especially given the increasingly worldwide use of literary, musical and performance rights. As a result, the establishment and enhancement of collective management organizations, or "societies", is a growing and necessary trend in many countries. These societies can provide for their members the benefits of the organization's administrative and legal expertise and efficiency in, for example, collecting, managing and disbursing royalties gained from the national and international use of a member's work or performance. Certain rights of producers of sound recordings and broadcasting organizations are sometimes managed collectively as well.

For more information, see *Creative Expression: An Introduction to Copyright and Related Rights for Small and Medium-sized Enterprises*, WIPO publication No. 918 and IP PANORAMA™ multi-media toolkit Module 05 at [www.wipo.int/sme/en/multimedia/](http://www.wipo.int/sme/en/multimedia/).

## Patents

A patent is an exclusive right granted for an invention, whether a product or a process, which must be industrially applicable (useful), new (novel) and exhibit a sufficient “inventive step” (be non-obvious). A patent provides protection for the invention to the owner of the patent. The protection is granted for a limited period, generally 20 years from the filing date.

Patent protection means that the owner of a patent has the exclusive right to prevent others from making, using, offering for sale, selling or importing the invention. These patent rights are usually enforced in a court, which, in most systems, holds the authority to stop patent infringement. Conversely, a court can also declare a patent invalid upon a successful challenge by a third party.

A patent owner has the right to decide who may – or may not – use the patented invention for the period in which the invention is protected. The patent owner may give permission to, or license, other parties to use the invention on mutually agreed terms. The owner may also sell the right to the invention to someone else, who will then become the new owner of the patent. Once a patent expires, the protection ends, and an invention enters the public domain, that is, the owner no longer holds exclusive rights to the invention, which becomes available for commercial exploitation by others.

All patent owners are obliged, in return for patent protection, to publicly disclose information on their invention in order to enrich the total body of technical knowledge in the world. Such an ever-increasing body of public knowledge promotes further creativity and innovation in others. In this way, patents provide not only protection for the owner but also valuable information and inspiration for future generations of researchers and inventors.

The first step in securing a patent is the filing of a patent application. The patent application generally contains the title of the invention, as well as an indication of its technical field; it must include the background and a description of the invention, in clear language and enough detail that an individual with an average understanding of the field could use or reproduce the invention. Such descriptions are usually accompanied by visual materials such as drawings, plans, or diagrams to better describe the invention. The application also contains various “claims”, that is, information which determines the extent of protection granted by the patent.

For more information, see *Inventing the Future: An Introduction to Patents for Small and Medium-sized Enterprises*, WIPO publication No. 917.1 and IP PANORAMA™ multi-media toolkit Module 03 and 06 at [www.wipo.int/sme/en/multimedia/](http://www.wipo.int/sme/en/multimedia/).

## Industrial Designs

An industrial design is the ornamental or aesthetic aspect of an article. The design may consist of three-dimensional features, such as the shape or surface of an article, or of two-dimensional features, such as patterns, lines or colors. Industrial designs are applied to a wide variety of products of industry and handicraft: from technical and medical instruments to watches, jewelry, and other luxury items; from house wares and electrical appliances to vehicles and architectural structures; from textile designs to leisure goods. To be protected under most national laws, an industrial design must be new or original and non-functional. This means that an industrial design is primarily of an aesthetic nature and any technical features of the article to which it is applied are not protected.

When an industrial design is protected, the owner – the person or entity that has registered the design – is assured of an exclusive right against unauthorized copying or imitation of the design by third parties.

For more information, see *Looking Good: An Introduction to Industrial Designs for Small and Medium-sized Enterprises*, WIPO publication No. 498 and IP PANORAMA™ multi-media toolkit Module 02 at [www.wipo.int/sme/en/multimedia/](http://www.wipo.int/sme/en/multimedia/).

For more information contact WIPO  
at [www.wipo.int](http://www.wipo.int)

World Intellectual Property Organization  
34, chemin des Colombettes  
P.O. Box 18  
CH-1211 Geneva 20  
Switzerland

Telephone:  
+4122 338 91 11

Fax:  
+4122 733 54 28