

How will Franchising be Affected by Brexit?

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Following the Brexit vote, the international franchise community needs to consider the implications of the exit of a major European economy, the United Kingdom, from the EU. Europe is an important market for many UK and US franchisors. How will franchising in Europe be affected by Brexit?

Supply chain

Franchise systems that involve the supply of goods and services to franchisees in Europe will need to prepare for the potential end to the free movement of goods in two years' time when the UK ceases to be a member of the EU. Import duties may be imposed by the EU on products made in the UK and UK franchisors that manufacture in Europe may need to reorganise their supply chain. Import from some non-EU countries, on the other hand, may become easier. Franchisors may need to identify countries with a strong treaty network and channel some products via those countries to minimise import duty. The next two years will be a period of uncertainty as franchisors have to decide whether to wait for the outcome of exit negotiations before restructuring their supply chain.

Examine supply contracts

Franchisors need to examine existing supply contracts to consider how and when they can be terminated or renegotiated. Where possible, franchisors may wish to terminate long-term contracts and replace them with shorter-term agreements allowing more flexibility during this period of change and uncertainty. Another potential option to consider would be to invoke force majeure provisions to end potentially

onerous contracts such as purchasing agreements with Euro pricing.

Increasing regulatory burden

Whilst importing from some non-EU countries may become easier, some franchisors may have to go back to old-style import departments to cope with the paperwork. Some franchisors are already identifying countries with a strong treaty network and may begin to channel certain product supplies via those countries to minimise import duty. Legal issues associated with importing from outside the EU include the need to comply on a per-country basis with a different set of rules regarding matters such as certificates of origin, safety certificates, import permits and licences. Currently the EU takes care of that. Franchisors will need to build their knowledge of import export laws and may have to increase head count in this area.

Competition law and online sales

EU competition laws have traditionally been pro-franchising, allowing franchisors to set maximum prices and providing generous exemptions from prohibitions imposed on other business trading in Europe. Many of these exemptions are based on EU case law, which will no longer be binding on

the UK following its exit from Europe but which will continue to apply in the rest of the EU.

The UK has its own well-established competition law regime but that regime is closely modelled on EU law. EU competition rules are designed to remove certain national barriers to cross-border trade such as exclusive territories and restrictions on purchasing parallel traded products. The EU competition laws also prohibit restrictions on online sales.

Post Brexit, franchisors may have more scope to ring-fence the UK market from competition from their own franchisees (particularly online competition). However, there is a risk that franchisors may also lose some of the current privileges that the EU courts have historically made available to them.

Franchisors need to evaluate the impact of these changes on their business model.

Enforcing the franchise agreement

Many international franchise agreements are governed by English law and subject to the exclusive jurisdiction of the English courts. At present, disputing parties within the EU rely on two main EU regulations to identify:

- which courts will have jurisdiction over a dispute;
- which law will be applied; and
- how a judgment will be enforced.

Going forward, these EU regulations would no longer apply.

Enforcing a UK judgment in EU Member States would depend in future on bilateral treaties between the UK and the relevant EU country or any future arrangement that the UK may be able to negotiate with the EU. It is also possible that the UK may sign the Lugano Convention or the Hague Convention.

In some cases, it may be open to foreign franchisees in the future to challenge the choice of English law to govern the franchise agreement – a particular risk if the franchise agreement does not have sufficient connection with the UK. However, if the franchisor is based in the UK, this will usually constitute sufficient connection, so the

concern arises principally for foreign franchisors using English law as a neutral law.

The bigger issue is thought to be the enforcement of UK court decisions. Potential solutions include choosing a non-exclusive jurisdiction, changing jurisdiction to the courts of a Lugano Convention country, such as Switzerland, or moving to arbitration as the preferred dispute resolution mechanism.

Protecting your IP

It seems inevitable that an unintended consequence of Brexit will be that the protection of intellectual property rights will become more expensive for franchisors.

In short, at present all 28 EU Member States benefit from a range of EU-wide intellectual property regimes such as EU trade marks and registered Community designs. Some intellectual property is centrally managed – such as trade marks administered by the European Intellectual Property Office (formerly OHIM). For franchisors that own or license intellectual property across a variety of European countries, these regimes are cost effective.

Patents

Plans were well advanced at the time of the EU referendum for a Europe-wide unitary patent, which meant that a single patent application would cover most European countries. This will generate massive cost savings. Post Brexit, franchisors will need separate UK and EU protection to cover all territories for their inventions and innovations.

Trade marks and designs

Currently, trade mark and design protection is available across all 28 Member States with a single EU trade mark (the EUTM, which was formerly called the CTM) and Community designs. In the future, national UK trade marks will need to be maintained separately from the EUTM and so franchisors will need to budget to spend more money in order to protect their trade marks and register in both the UK and the EU rather than just in the EU. It is likely, however, that there will be some form of transitional regime to deal with any existing EU trade mark portfolios (which would currently cover the UK) to enable those

trade marks to retain or obtain protection in the UK once it leaves the single market.

Another issue for franchisors to consider is the impact of changes to the current system for registering their trade marks with customs authorities in the EU to help prevent the importation of counterfeit products. It will be important in future to ensure that both national and EU rights are registered with customs. It remains to be seen whether there are other enforcement issues looming as it is not clear whether the UK will continue to have access to the Enforcement Database, which contains information on products that are granted an intellectual property right (such as a registered trade mark or design). At present, police and customs officials of all 28 Member States can access this tool to view information and product details, making it easier for them to identify counterfeits and take action.

Copyright

Most franchise systems rely extensively on copyright to protect their operations manuals, logos, unregistered trade marks, databases and software. Given the cross-border nature of franchising, most franchisors and franchisees wish to rely on a broad range of cross-border intellectual property protection to deal with copyright infringers.

Many domestic copyright laws in the UK stem from EU laws and the various Member States of the EU have increasingly aligned their approaches over time. Courts in the UK interpret such laws consistently with decisions of the European Court of Justice.

The effect of Brexit on copyright is still unclear. We recommend that franchisors monitor changes to the enforcement regimes. This is especially so with the notice and take down processes, which are at present operated by online hosts in response to court orders or allegations that certain content is illegal.

Trade secrets

In April 2016, the European Parliament had approved the new European Union Trade Secrets Directive, which is designed to protect trade secrets. The new law has been of great interest to franchisors as confidential information forms the

basis of most franchise systems and can be notoriously difficult to protect.

It now seems certain that the UK will not be enacting any national laws to implement the new Directive and so the UK law and European law will continue to diverge. Franchisors should, in the meantime, ensure that their confidentiality agreements comply with both UK and European laws. Franchisors should ensure they have contractual rights in the franchise agreement to provide protection against unlawful uses of their trade secrets as they will not be able to benefit from the new Directive.

Impact on employees

Stopping the free movement of EU workers was a key factor in the Brexit vote. It is unlikely that the EU will allow the UK to close its borders to EU workers whilst allowing UK workers full freedom of movement in Europe. Franchises that rely on UK nationals to work in Europe in the franchise (whether in the franchisee or the franchisor business) to support the local franchise network may need to apply for work visas and residence permits. An alternative would be to consider hiring EU citizens to fulfil these roles.

Fortunately franchisors will have two years to consider their employment strategy. Most franchisors do not employ a large number of staff abroad, as the franchisees will be the principal employers of the local workforce, but local support offices may be affected.

Another issue is that a significant proportion of the UK's domestic employment legislation is also driven by the EU and it is unclear whether this will remain the case. The Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) protects workers by automatically transferring contracts of employment when there is a transfer of a business – which may occur when there is a change in the franchisee allocated to a territory or customer group. These laws restrict what can be done in respect of transferring employees. It seems unlikely that there will be a complete repeal of TUPE given the current political landscape and the fact that these workers' rights have been a feature of the legal regime for around 30 years, but, until the issue is dealt with, uncertainty will remain.

Franchisors should nevertheless review their current TUPE contractual provisions to ensure that, if there is a wholesale change in the legal regime, the TUPE provisions will be able to be varied.

Action plan

In summary, the direction of travel under the EU has been to harmonise laws and, with Brexit, the direction will be fragmentation as laws in the UK diverge from those that apply in the EU. There will be considerable uncertainty until the new regime has been put in place, which may take up to two years. We emphasise that EU intellectual property rights of franchisors and franchisees are still enforceable in the UK in the interim.

Franchisors should put together an action plan to address the potential impact of Brexit on their business. Key issues to consider would include:

- Impact on the supply chain, particularly where the system involves supply of products to franchisees in Europe or the sourcing of products from EU Member States.
- Impact on your intellectual property portfolio. Leaving the EU will mean that rights such as European trade marks or registered designs

are no longer valid in the UK. Franchisors will need to review their IP portfolio, filing and enforcement strategies and consider filing additionally for national protection in the UK.

- Impact on staff. Franchisors should review to what extent they are reliant on free movement of workers. Contingency plans should be made for staff working in Europe and for potential transfers on termination of relationships.
- Impact on legal agreements. If your agreements are governed by English law and subject to the jurisdiction of the English courts, will you have difficulty enforcing them post Brexit?
- Competition law. Franchisors may lose the special privileges created by European case law. However, they could benefit from a better ability to ring-fence their domestic market.

The Franchising group will be hosting individual workshops around this topic for clients who need one-to-one advice, as well as incorporating the topic into its well-known masterclass series. If you have any queries or need advice or assistance in planning for Brexit, please contact Babette Märzheuser-Wood or Robyn Chatwood.

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