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New Challenges for International Franchising

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THE IMPACT ON BREXIT ON FRANCHISING

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1. Background

On June 23rd 2016, 51.9% of eligible UK population voted for the UK to leave the European Union (EU). The withdrawal process is governed by Article 50 of the Treaty on European Union¹. Under Article 50, when a member notifies the European Council of its intention to withdraw, the EU is required to "negotiate and conclude an agreement with the leaving member State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the [European] Union"². The negotiation period is limited to two years unless extended, after which the treaties cease to apply and the leaving State ceases to be a member of the EU.

Article 50 was invoked by notice served by the UK Government on March 29th 2017 thereby commencing the withdrawal process commonly known as Brexit. From the very outset, the process was fraught with difficulty, with the UK Government's right to invoke Article 50, without an authorising Act of Parliament being challenged through the Courts. On 24th January 2017, the Supreme Court unanimously ruled against the UK Government in the Miller case³ holding that the withdrawal process could not be initiated without an authorising Act of Parliament and, rejecting the Scottish Government's claim in respect of devolution. Consequently, the European Union (Notification of Withdrawal) Act 2017 was passed in March 2017⁴ empowering the UK Government to invoke Article 50.

Therefore, the negotiation period for the conditions on the UK's exit from the EU was due to expire and, the UK would cease to be a member of the EU at 11pm on 29th March 2019. However, following a rejection by the UK Parliament of the Government's proposed agreement on withdrawal conditions on 14th March 2019, this period was extended by two weeks, to give the UK Parliament time to reconsider its rejection. The UK was now due to leave the EU at the end of 12 April 2019 (24:00 Central European summer time; 23:00 British summer time) however, a further 'flexible' extension has been granted until 31 October 2019 following talks at the European Council meeting on 10 April. Since that date, there remains a failure to reach a consensus on the terms for withdrawal in the UK Parliament and all parties continue to work on contingency measures to seek to mitigate some of the biggest risks associated with a no-deal Brexit.

In an effort to maintain status quo in the interim, the European Union (Withdrawal) Act 2018⁵ was passed by the UK Parliament on June 26th 2018 allowing for the repeal of the European Communities Act 1972 and restating in UK law all enactments previously in force under EU law. In addition the Government's Department for Exiting the European Union has issued various technical notices and guidance on certain key areas which may be affected by Brexit, outlining its approach and, how such areas may be affected by a "no deal" Brexit⁶ but these are limited in scope and often lack legal certainty.

As at the date of this paper, the outcome is still not known and, remains potentially any of the following:

- no withdrawal;
- a managed withdrawal based on some form of withdrawal agreement; or
- withdrawal without agreement with the EU, often referred to as a "hard Brexit".

The impact on franchised businesses depends on which outcome materialises. If there is a deal then in most cases there will be no immediate change to laws. There will be a significant reorientation from the EU to the UK in areas such as; funding and UK enforcement of certain laws that were previously enforced

¹ Article 50 of the Treaty on the Functioning of the European Union

² Article 218 (3) of the Treaty on the Functioning of the European Union.

³ R (Miller) v Secretary of State for Exiting the European Union [2017] UKSC 5

⁴ <http://www.legislation.gov.uk/ukpga/2017/9/contents/enacted>

⁵ <http://www.legislation.gov.uk/ukpga/2018/16/contents/enacted>

⁶ <https://www.gov.uk/government/organisations/department-for-exiting-the-european-union>

by the EU (e.g. state aid and sanctions) and, the UK will have far less input into EU lawmaking. However if there is no deal and the UK exits the EU without any agreement with the EU in place, a far more pressing set of circumstances arises.

This paper considers what this means in a number of the key legal areas that are relevant to franchised systems of ways. The impact is clearly more significant for those franchise systems, which have a cross border element to their business, whether it is through the supply chain, international expansion or recruitment. Here some form of Brexit planning is prudent to help ensure any potential disruption to business is minimised where possible and contingencies put in place.

2. Intellectual Property

The licensing of trade marks, know-how and other intellectual property by a franchisor to a franchisee is of course a key element of franchising and, it is essential to ensure that this intellectual property is effectively protected for both parties interests. UK national intellectual property rights, which only cover the UK, will continue largely uninterrupted should there be a ‘hard’ Brexit and no immediate action should be necessary. However EU trade marks (EUTMs) and EU registered designs (known as Community registered designs (CRDs)) are EU ‘unitary’ rights covering the whole of the EU and these will (by definition) cease to cover the UK on the withdrawal date when the UK ceases to be a member of the EU.

2.1. Trade Marks and registered Design Rights

The UK Government has issued a technical notice on trade marks and designs⁷ addressing this issue and noting that “an estimated combined figure of 1.7 million EU trade marks and registered Community designs are in force (2017 figures), along with over 200,000 international trade mark and design registrations covering the EU”⁸. According to the technical notice, in the case of a no-deal Brexit, holders of EUTMs and CRDs can continue to be protected in the UK, by the provision of an equivalent trade mark or design registered in the UK, which (apparently) will be granted with “minimal administrative burden”. An opt out provision will be made available to those businesses, organisations or individuals who may not wish to receive this comparable trade mark or design in the UK. It would appear therefore that no action is required to be taken for holders of registered EUTMs and CRDs as at the withdrawal date.

However for those pending applications, as at the withdrawal date, or for new applications made after the withdrawal date, an application for the comparable UK trade mark or registered design will need to be re-filed or filed within 9 months from the withdrawal date with the UK Intellectual Property office and a fee (yet to be specified) paid.

UK applicants wishing to seek protection for their intellectual property rights in the EU can continue to do so in the usual way without change but, will also have to register for a UK trade mark or registered design to ensure it has domestic protection.

The key change therefore affects those franchisors wishing to seek protection for their intellectual property rights, which have yet to be registered as at the withdrawal date, here, a separate registration for the UK will be required in the event of a no deal Brexit. Procedures should be implemented to take advantage of arrangements made by the UK Intellectual Property Office to provide continued UK protection and a ‘health check’ carried out on protection in the relevant EU markets.

(i) Unregistered design rights

Where a franchisor is licensing an EU unregistered design right then these rights will continue to be protected and enforceable in the UK for the remaining period of protection of the right. In addition the UK Government has stated that the UK will create a new unregistered design right which mirrors the characteristics of the unregistered Community design, this will be known as the supplementary unregistered

⁷ <https://www.gov.uk/government/publications/trade-marks-and-designs-if-theres-no-Brexit-deal/trade-marks-and-designs-if-theres-no-Brexit-deal>

⁸ Ibid

design right⁹. Therefore existing unregistered Community designs in the UK will continue following Brexit via the supplementary unregistered design right and no further action is required. For eligible designs disclosed after the withdrawal date, the supplementary unregistered design right will also arise automatically.

2.2. Other licensed rights

(i) Copyright and Database rights

In so far as copyright law in the UK is derived from international copyright conventions and treaties the position should remain largely unaffected, however some copyright laws in the UK derive from directly applicable EU regulations and EU Directives and it is here the greatest risk of change is faced. Although the UK laws derived from the EU Regulations and Directives will continue to apply in the UK, by virtue of the EU Withdrawal Act 2018, subsequent changes to EU copyright law will not automatically apply in the UK, unless these are also enacted at UK level. However the most significant impact will be on the current cross-border copyright mechanisms which operate within the EU and which the UK is currently able to benefit from. In its position paper of 28th March 2018, the European Commission has confirmed that, subject to any transitional arrangement contained in a withdrawal agreement, the EU rules in the field of copyright will no longer apply to the United Kingdom from the withdrawal date¹⁰. This is because the UK will be deemed to be a third country for these purposes. This position has been confirmed by the UK Government in its Technical Notice on the impact on copyright in the event of a no deal Brexit¹¹.

In a franchise context the key impact of this is likely to be felt in the case of database rights. Currently under the database directive¹² nationals, residents, and businesses of EEA member states are eligible for database rights in all EEA member states. These rights do not arise in relation to databases created or owned by non-EEA citizens, residents, or businesses. However, in the event of a no-deal Brexit, EEA states will no longer be obliged to offer these rights to UK nationals, residents and businesses. Further, those in the UK who own a database may no longer be able to enforce this right in the EEA once the UK leaves the EU¹³. Therefore UK franchisors that provide information and other services based on databases should consider transferring rights to group companies established in the EEA prior to the withdrawal date, in order to avoid losing database rights in the European Economic Area member states at Brexit and vice versa. In addition, other forms of protection could be relied upon including restrictive licensing agreements or copyright where applicable for their databases.

(ii) Domain names

At the withdrawal date UK companies and organisations (if not established in the EU) and individuals resident in the UK will no longer be able to register .eu domain names and if they already hold them, will not be able to renew them. In addition, the .eu domain registry has announced that it will revoke domains owned by persons with UK or Gibraltar contact details.¹⁴ For those franchisors who may be affected, they could consider transferring the .eu domain to an appropriate associated company or introducing an additional top level domain (such as a .com or .co.uk) immediately to reduce disruption at the withdrawal date.

⁹ Ibid.

¹⁰ <https://ec.europa.eu/digital-single-market/en/news/notice-stakeholders-withdrawal-united-kingdom-and-eu-rules-field-copyright>

¹¹ <https://www.gov.uk/government/publications/copyright-if-theres-no-Brexit-deal/copyright-if-theres-no-Brexit-deal>

¹² Database Directive (Directive 96/9/EC of the European Parliament and of the Council of 11 March 1996 on the legal protection of databases, extended to the EEA in paragraph 9a, Annex XVII of EEA Agreement)

¹³ <https://www.gov.uk/government/publications/copyright-if-theres-no-Brexit-deal/copyright-if-theres-no-Brexit-deal>

¹⁴ European Commission Directorate-General For Communications Networks, Content And Technology (28 March 2018) notice to stakeholders
Withdrawal of the united kingdom and eu rules on.eu domain names

Franchisors should review their existing intellectual property licenses (both in and out) to ensure that the definitions still operate as intended – for example the definition of the licensed territory may require amending and licensing arrangements which treat the EU/EEA as a single licensed territory will require amendment.

3. Immigration and Employment

The free movement of EU citizens and immigration was one of the hotly debated topics prior to the referendum and one of the first areas to be addressed in negotiations with the EU who was keen to seek assurances. The UK Government has now provided details of the “EU Settlement scheme”¹⁵. Under this scheme EU citizens and their family members will have to apply for either settled status (where an EU citizen has been residing in UK for five continuous years) or pre-settled status (where an EU citizen has been residing in UK for less than five continuous years) to remain in the UK following the withdrawal date.

Under the draft withdrawal agreement, EU citizens, resident in the UK by 31 December 2020, will need to apply to remain under the EU Settlement scheme by 30 June 2021. In a no-deal Brexit scenario, the EU Settlement scheme will apply to EU citizens and their family members who are actually resident in the UK by 29 March 2019. The deadline for making an application for settled or pre-settled status under the scheme would be 31 December 2020. With a no-deal Brexit, family members can still join the EU national. However, there is a time limit of 29 March 2022 imposed and the relationship between the EU national and their family member must have existed by 29 March 2019 (with the exception of future children born from 30 March 2019 onwards). There is no fee to apply under the scheme and those that have already paid will be granted a refund.

For franchise systems who may rely on immigrant workers (particularly those in the hospitality and fast food sectors) or the domiciliary care sector this is a particular issue. If not already actioned, employers (both franchisor and franchisee alike) should undertake a full audit of their workforce to identify those persons who may be impacted by Brexit and consider what level of support and resources they are willing to provide to employees who will need to apply for status under the EU Settlement scheme or for a Permanent Residence document under the existing rules. Most franchise agreements do require franchisees to ensure that their employees are able to work within the franchised territory but internal training may well be required to ensure that this is followed through in practice and perhaps diarising to undertake a full right to work checks on all employees well before the EU Settlement scheme deadline for applications on 30 June 2021, or , in the event of a no deal Brexit, October 2020, to ensure that all employees still have the right to work in the UK.

Businesses should ensure that offer letters and contracts of employment make it clear that the offer and ongoing employment are conditional upon the person being able to demonstrate that they have the right to work in the UK.

For businesses with UK nationals working in EU countries, local immigration advice should be taken to safeguard employees’ status abroad. Although the UK has urged the EU to offer UK nationals residing in the EU, reciprocal protection to that provided by the EU Settlement scheme, this remains an open issue with no guarantees from the EU.

Even if there is a no deal Brexit, EU nationals will be able to continue to come to the UK to live and work during the period up to 31 December 2020 under a new status called European Temporary Leave to Remain (ETLR). However, EU nationals who arrive after 11pm on 29 March 2019 and who are granted ETLR for three years may not qualify under the new immigration system to stay for longer once their three years’ leave expires.

4. GDPR and data transfers

¹⁵ <https://www.gov.uk/settled-status-eu-citizens-families>

The UK Government has issued updated advice on the transfers of personal data from the UK to the EU and has confirmed that there is no immediate change proposed to the UK's data protection standards particularly given the recent implementation of the General Data Protection Regulation ("GDPR")¹⁶ in UK law. As a result, the UK Government considers there to be a substantial alignment with EU data protection standards.¹⁷ In recognition of this alignment, UK businesses or organisations will continue to be able to send personal data from the UK to the EEA and other third countries deemed adequate by the EU at the withdrawal date.

However, the same cannot be said for the EU's stance and at present, the UK faces the prospect of being regarded as a third country when it exits the EU. This would affect the transfer of personal data from organisations within the EU to UK organisations and such transfers would have to be subject to strict data transfer rules, as set out by the GDPR to ensure the transfers are lawful. For franchise systems, which require the transfer of personal data from the UK to the EU the UK Government, is advising that appropriate contracts are put in place to ensure compliance with privacy laws following the withdrawal date.

5. Competition law

UK businesses that undertake business in the EU will continue to be subject to EU competition law and vice versa. What is not known is whether changes to EU competition law will continued to be mirrored in UK competition law following the withdrawal date and, whether competition law infringement decisions of the European Commission will be followed by the UK Courts. It is likely however that there will be little substantial difference in the short term and franchisors seeking to include potentially anti-competitive provisions in their UK franchise agreements (such as; as exclusive purchase obligations and in term and post term restraints on trade) will continue to draft these (where possible) to fall within the European Vertical Block Exemption Regulation ("VBER")¹⁸. The VBER exempts certain agreements and practices from the EU's general competition rules but it is due to expire on 31 May 2022, after the withdrawal date. Therefore, in the event of a no deal Brexit it remains to be seen what position the UK will adopt and whether it will continue to align with the European Union in this regard.

Following the withdrawal date and in the event of a no deal Brexit, the UK will not be part of the EU Civil Judicial Cooperation regime, which governs certain aspects of claims for damages for infringements of EU competition law. In addition, the UK will no longer be part of the one-stop shop EU merger control regime, meaning deals meeting EU and UK thresholds may need to be notified in both jurisdictions after Brexit.

More recently, the Geo-Blocking Regulation¹⁹ came into force in member states (including the UK) on 3rd December 2018 forming a key stone of the European Union's digital single market strategy. It seeks to address unjustified on line sales discrimination based on a customers' nationality, place of residence or place of establishment within the European Union. The UK Government's Technical Notice on the Geoblocking Regulation²⁰ advises that in a 'no deal' scenario, the UK version of the Geo-Blocking Regulation would be repealed. The UK would again be considered to be a third country and therefore whilst the original EU Geoblocking Regulation will continue to apply to UK businesses operating within the EU who would be prevented from discriminating EU customers, the same protections would not be afforded to

¹⁶ <https://gdpr-info.eu/>

¹⁷ <https://www.gov.uk/guidance/using-personal-data-after-Brexit>

¹⁸ <https://eur-lex.europa.eu/eli/reg/2010/330/oj>

¹⁹ Regulation (EU) 2018/302 of the European Parliament and of the Council of 28 February 2018 on addressing unjustified geo-blocking and other forms of discrimination based on customers' nationality, place of residence or place of establishment within the internal market and amending Regulations (EC) No 2006/2004 and (EU) 2017/2394 and Directive 2009/22/EC <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32018R0302>

²⁰ <https://www.gov.uk/government/publications/geo-blocking-of-online-content-if-theres-no-Brexit-deal/geo-blocking-of-online-content-if-theres-no-Brexit-deal>

UK consumers. This could leave UK franchise systems with an active e-commerce channel at a disadvantage when compared to their EU counterparts.

6. Exporting and Importing Goods

The UK Government's Technical Notice on the importation, exportation and transport of goods²¹ (last updated on 22nd February 2019) simply advises that there may well be changes in customs, tariffs, VAT, safety and security, documentation, vehicle standards, and controlled products. and excise procedures as well as documentation may change increase shipping times. In the event of a no deal Brexit the UK Government is putting into place transitional simplified procedures in an effort to make importing easier. This seems to rely heavily on electronic submissions and the reality is likely to be, that the UK Government simply does not have sufficient resources to facilitate a streamlined process. This is a significant concern for franchise systems that rely on the importation of goods into the UK such as food items. With the possibility of delays at the border, imposition of tariffs and currency fluctuations the future appears at the best uncertain and many businesses are attempting to stock pile where they can ahead of the withdrawal date or to put into place alternative supply routes.

In addition, there may well be differences in the regulatory requirements following the withdrawal date, which would require packaging to be changed or new regulatory standards to be adopted. All of which is an additional expense for businesses potentially eating into the profit margins to be made by both franchisor and franchisee. Franchisors should review their current supply arrangements and consider re-negotiating commercial terms to allow for an exit should the arrangement become too expensive.

7. Litigation

In the event of a no-deal Brexit, the so called "Recast" Regulation²² which currently governs the enforceability of judgements obtained in a member state across the EU will no longer apply between the UK and EU after the withdrawal date²³. To mitigate the uncertainty this leaves, the UK Government has published draft legislation, which will only apply in the event of a no deal Brexit²⁴ and clarifies how the English courts will enforce foreign judgments following the withdrawal date. It has indicated that it will continue to enforce judgments given in other EU/EEA states if judgment was obtained or the proceedings commenced on or before the withdrawal date. It has also taken action to adopt the 2005 Hague Convention on choice-of-court agreements and therefore will recognise and enforce judgments where the parties have concluded an exclusive choice-of-court agreement.

Similarly, the EU has published its own (non legally binding) Notice to clarify the EU's position on how English judgments will be enforced in the courts of the remaining EU member states²⁵ and takes a different stance to the UK. The EU has indicated that the remaining EU member states will not apply the Recast Regulation to English judgments obtained prior to the withdrawal date or proceedings that commenced before or after this date. The national law of each EU/EEA state will determine whether a foreign UK judgment can be recognised and enforced in that jurisdiction and enforcing UK court judgments in EU states will be subject to their national procedural laws. Given the long-standing co-operation, which exists between the UK and member states it, is unlikely that a member state will seek to restrict the enforceability of an English judgement but uncertainty remains as to whether fresh proceedings or further administrative hurdles will need to be commenced or overcome.

²¹ <https://www.gov.uk/guidance/importing-exporting-and-transporting-products-or-goods-after-Brexit>

²² REGULATION (EU) No 1215/2012 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL. of 12 December 2012. on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast)<https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2012:351:0001:0032:en:PDF>

²³ <https://www.lawsociety.org.uk/support-services/advice/articles/no-deal-Brexit-guidance-civil-commercial-cooperation/>

²⁴ Civil Jurisdiction and Judgments (Amendment) (EU Exit) Regulations 2019 No. 479

²⁵ Notice to Stakeholders, Withdrawal of the United Kingdom and EU rules in the field of Civil Justice and Private International Law

Brexit however does not have a direct effect on arbitration and therefore the recognition and enforcement of Arbitration awards will be unaffected. The UK like the other members states of the EU are signatories to the New York Convention²⁶ and therefore arbitration awards made in London should continue to enforceable throughout the EU. Arbitration clauses may therefore become more attractive to franchisors contracting with franchisees in the EU and London has long been renowned for being a centre for intentional arbitration. Arbitration also has the advantage in that its proceedings are generally confidential, which for franchisors keen to reduce reputational risk is an added bonus.

8. Conclusion

Brexit remains fraught with uncertainty and no franchisor can have a crystal ball but there are steps that can be taken to mitigate against some of the potential risks involved, particularly in a no deal scenario. Some of these are simply good housekeeping and others require a strategic approach such as hedging against potential currency fluctuation or re-negotiating supply terms. Franchise agreements can also be amended to incorporate a so-called “Brexit” clause for those franchise systems where a no deal Brexit could prove extremely onerous allowing for any material adverse change because of Brexit, to trigger a break cause. However, despite the uncertainty, very few franchisors are seeking to include such clauses, perhaps considering these to be a deterrent to recruitment and, instead are preferring to wait and see. The impact of Brexit on franchising is yet to be determined.

²⁶ Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958)http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html