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International Franchising in a Changing World

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NEWS FROM AROUND THE WORLD – UK

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1. Introduction

The last 12 months in the UK have been dominated by the fallout following the UK's surprise decision to leave the European Union ("**EU**"). A brief timeline is as follows:

- Following the result of the referendum in June 2016, David Cameron resigned as Prime Minister and shortly thereafter, Theresa May took his place.
- Scotland voted to remain in the EU, and on March 28 2017, the Scottish Parliament voted in favour of a second independence referendum with a view to secure its membership of the EU – this has yet to be accepted by the UK Government.
- On March 29 2017, the UK Government formally triggered Article 50, which has started a 2 year process of formal exit talks.
- On March 30 2017, the UK Government published the Great Repeal Bill, which will repeal the 1972 European Communities Act, which took Britain into the EU and meant that European law took precedence over laws passed in the British parliament. It will also end the jurisdiction of the European Court of Justice.
- On 18 April Theresa May called for a snap general election, which will be held on 8 June 2017.

Amid all of this political turmoil, there has been very little by way of non-Brexit related, new Government policy or laws which have passed through the UK Parliament. However, as the shape of a deal with the EU emerges and we get closer to leaving the EU, there is likely to be a significant amount of change in English law which will ultimately apply to franchising.

In the background, there have nevertheless been some other very interesting developments in the UK.

- The UK Supreme Court issued what is arguably the most important judgment in the last 100 years of common law, on the issue of contractual penalties
- Following an Employment Tribunal case which found against Uber, the UK Government has set up an independent review of current UK employment law, which will look to recommend changes in employment law to deal with issues in the growing self-employed section of the economy and the "gig economy".
- In other relevant news, there is new legislation on payment practices and, following the decision by the European Franchise Federation ("**EFF**") to adopt a new version of the European Code of Ethics for Franchising ("**Code of Ethics**"), the first update for 13 years, EFF's accredited national franchise association for the UK , the British Franchise Association ("**BFA**") voted in favour of adopting the latest version of the Code of Ethics at its Annual General Meeting on 8 December 2016. The BFA is now working on updating its national Code of Ethics accordingly.
- For a commercial perspective, franchising in the UK continues to grow its share of the economy and the following trends are emerging:
- Fewer franchisees – and more units:
- Growing number of multi-brand operators
- Increase in size of franchised businesses
- Increase in the number of UK owned franchise systems
- Some sectors doing better than others – F&B, leisure and hotels on increase. Transport/commercial services, retail with little growth or lower profitability.

2. Brexit

Since the United Kingdom voted to leave the EU on 23 June 2016, "**Brexit**", and what it may or may not mean has dominated the national conversation. In the absence of a crystal ball, we will not know what Brexit is going to mean until we are some way into the negotiations with the EU. However, in a recent speech by Theresa May, the UK Government has given the first meaningful insight into the type of Brexit it will be pursuing - UK Government will be looking to leave the single market (referred to as the "**European Economic Area**" or "**EEA**") and possibly some or all of the customs union (which will free the UK to enter into its own trade deals), whilst trying to retain as much access as is possible to the EEA.

So what does this mean for the franchise community? We have identified five key issues that all franchisors doing business in the UK and/or EU should be considering now.

2.1 Trademarks, design rights and brand protection

It is not clear what mechanism will operate in relation to successor rights to EU trade marks ("**EUTMs**") (and Registered Community Designs) in the UK when the UK leaves the EU, and whereas both scenarios are unlikely, it is possible that a) EUTMs will simply stop being enforceable in the UK or b) the EUTM system will continue to cover the UK. Much more likely though is that the EUTM owners at the time of Brexit will be granted successor rights under national UK trade mark law one way or another so that their priority is recognised (there are various ways that might happen).

But where does that leave the surviving EUTM? Assuming the UK does leave the system, if an EUTM is more than five years from registration it will be vulnerable to cancellation from the EUTM register and will not be enforceable if it is not in genuine use. If the only use is and has been in the UK and it is not being used in any other EU territory, then the EUTM may eventually become vulnerable once the UK use is no longer maintaining it. If therefore keeping an EUTM enforceable and maintaining its priority is important to a business then they might consider putting the EUTM registration into use by way of licence or franchise arrangement in an EU member state. An interest in maintaining the EUTM with genuine use in the EU may affect plans or decisions about partners in the EU whether you are based in the UK or elsewhere.

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 may start to diverge over time. Franchisors should, in the meantime, ensure that their confidentiality agreements comply with both UK and European laws.

2.2 Data Protection

Franchise businesses which collect and use data from European citizens – whether established in the EU or not - should already be aware that the legal landscape changed prior to Brexit with the implementation of the EU General Data Protection Regulation ("GDPR") which came into force on 25 May 2016. There has been a lot of debate about whether the GDPR will still apply in the UK once it exits the EU. This speculation was seemingly ended on 21 December 2016 when the UK Government released a report confirming its intention to apply the GDPR despite Brexit.

The process of exiting from the EU is likely to be a protracted affair and, during the interim period at, least, the UK will remain fully subject to EU laws – including EU data protection laws.

Businesses still need to undertake their GDPR readiness preparations. When it comes into effect in May 2018, the GDPR will apply to every business - whether in the EU or not - that offers goods and services to EU citizens or that monitors EU citizens' behaviour. UK businesses selling into the EU will therefore still be subject to GDPR requirements, as will wider international businesses operating across the UK and the EU. The UK's leaving the EU won't change this. If the UK doesn't stay part of the EEA, then it will in effect become a "third country" for data protection purposes - meaning that data transfers from the EEA to the UK could be restricted in the same way as data exports from the EEA to the US. Or, more accurately, they'll be restricted unless the EU Commission decides that the UK provides "adequate" protection for data it imports from the EEA, as is the case currently with countries like Canada and New Zealand. Whether that happens will very likely depend on the next point…

If the UK doesn't stay part of the EEA (meaning it won't become subject to the GDPR), then it will need to adopt new national data protection laws (and might be tempted to adopt a "GDPR-lite" regulation) or continue its reliance on the Data Protection Act 1998. It will need to tread very carefully if it follows this path - while it might be tempted to adopt more relaxed data protection rules than the GDPR to attract investment from countries like the US, if these rules aren't "strict enough" then it also risks not achieving "adequacy" recognition by the EU, seriously impacting data flows between the UK and the EU.Non-compliant businesses under the GDPR risk fines of up to 4% of global turnover.

2.3 Antitrust/Competition law

EU competition law prohibits anti-competitive agreements and abuses of a dominant position. In the context of franchising, EU competition law most commonly has an impact on:

(a) Territorial and customer restrictions that franchisors wish to impose on franchisees. Whilst franchisees can be protected within exclusive territories from active sales by other franchisees in their territories, franchisees cannot be prevented from engaging in passive sales (responding to unsolicited orders) from anywhere within the EEA. Online sales also cannot be restricted within the EEA.

(b) Pricing restrictions on franchisees. Requiring franchisees to comply with fixed or minimum resale prices is strictly prohibited except in certain very limited circumstances.

(c) In and post-term non-compete clauses. These are permitted in order to protect the know-how transmitted by the franchisor to the franchisee provided that, in the case of post-term restrictions, they are reasonable in duration and scope.

Post-Brexit, these rules will continue to apply to any franchising agreement that has or may have an effect on trade between the remaining EU Member States. This could include agreements with a UK element if they cover, or could have effects, in multiple EU Member States.

For purely UK agreements, it would be open to the UK to depart from EU competition law and adopt a more or less onerous regime. At present the future of competition law in the post-Brexit era is not known. However, it is unlikely that in the short term post-Brexit there is likely to be significant change. UK competition law, as embodied in the Competition Act 1998, is largely based on EU competition law and the case law based on that Act draws heavily on EU case law. Absent major legislative change, it will take some time for any material changes of interpretation to feed through into case law.

An area in which divergence is perhaps most likely to arise is territorial and/or online restrictions. EU competition law rules on territorial and online restrictions are driven by the overriding objective of the EU to promote and complete the EEA. Outside the EEA, such considerations will no

longer be of relevance to the UK. It would be open to the UK to take a more economically liberal approach and allow franchisors to offer much greater territorial protection to franchisees and/or regain greater control over online activities. Whether this will occur remains to be seen.

2.4 Jurisdiction and Enforcement

The UK is currently party to various regulations and conventions that ensure that the courts of EU member states apply jurisdictional rules to determine when they will accept jurisdiction over a dispute and that a judgment given in one member state will, subject to certain exceptions, be enforceable in all other participating states. Many UK based franchisors elect for the English courts to have exclusive jurisdiction over their franchise agreements and for good reason; they are world renowned for a reputation of quality and for supporting the needs of modern commerce.

But one result of Brexit could be that the UK must replace these arrangements or face the prospect of its courts' judgments becoming less effective across Europe.

It's too early and uncertain to be considering whether Brexit should change our approach to something as important as jurisdiction/forum clauses. No-one knows how Brexit will play out, and even when Article 50 will be invoked, it will take years for us to attain even a degree of detachment from existing legal recognition/enforcement arrangements even if that is the outcome of Brexit.

It seems likely that English law will remain the dominant governing law for commercial contracts globally: English law will largely be unaffected by whether the UK remains part of the EU or not. It will continue to be selected by businesses for certainty as the choice of law for most commercial arrangements.

2.5 Contractual provisions

One outcome of Brexit will be that franchisors need to carefully examine the legal contracts which underpin their existing relationships with franchisees and suppliers.

Franchisors should audit their existing legal agreements in order to ascertain whether any express terms need to be amended or varied as a result of Brexit. For example, references to a defined territory of the European Union and/or EEA may need to be updated to accurately reflect the UK's new position. Equally, references to EU regulations may need to be amended, depending upon the application of such laws to the UK going forward.

However, perhaps of most significance is whether or not Brexit will frustrate areas of contractual performance, or render the commercial bargain as unviable to either or both parties. One obvious area where this could apply is in relation to the imposition of trade tariffs on goods flowing between the UK and EU. It is unlikely that existing force majeure clauses could be relied on as means of terminating a contract on these grounds, but it poses the question of whether franchisors which have identified potential vulnerabilities should consider building in an express right of termination or re-negotiation to mitigate this risk. If they do, careful drafting will be required around pricing mechanisms or describing the events which would activate the new contractual rights.

The challenge that franchisors seeking this flexibility may face from franchisees is that franchising is a long term relationship which requires a high degree of contractual certainty - operating on shorter terms or building in unilateral or mutual early termination clauses is likely to have a detrimental impact on a franchisor's ability to attract and retain long term franchisees who are willing to invest in their business concept. Introducing this type of flexibility is arguably more realistic within a franchisor's supply chain, which will typically operate under shorter term agreements.

2.6 Conclusion

Franchise businesses should start preparing for the potential impact of Brexit by auditing their IP rights in the EU and assessing their key contractual relationships with suppliers and franchisees. Preparations for GDPR should continue and a watchful eye should be kept on events as they unfold – if the last 12 months has taught us anything, it is to expect the unexpected!

3. Important changes to the English law rule on penalty clauses

In a recent landmark decision, the highest court in England and Wales, the Supreme Court, considered the long established principles underlying the law relating to contractual penalty clauses (the "**penalty rule**"). The Supreme Court issued a joint judgment in the cases of Cavendish Square Holding BV v Talal El Makdessi (El Makdessi) and ParkingEye Ltd v Beavis [2015] UKSC 67 (ParkingEye), which is one of the most important decisions in English common law for the last 100 years.

The Supreme Court judgment sets out a new, progressive test for determining whether or not a contractual provision will be considered penal and therefore unenforceable. The judgment is relevant to all franchise systems which operate under English law agreements, as it re-calibrates the application of the penalty rule and potentially gives franchisors greater scope to deter certain types of behaviour and impose contractual penalties for certain types of breaches.

3.1 What was the penalty rule?

The origins of the penalty rule can be traced back as far as the 16th century, and essentially, a penalty is a payment stipulated in the contract which is unenforceable against the offending party if it is an exorbitant alternative to common law damages for breach.

At the beginning of the 20th century, the judgment in the case of Dunlop Pneumatic Tyre Co Ltd v New Garage & Motor Co. Ltd [1915] A.C. 847 (Dunlop) sought to restate the law on the penalty rule by providing four tests which were designed to be "helpful, or even conclusive" in determining whether or not a clause was an unenforceable penalty. The Dunlop judgment distinguished between penalty clauses (which are unenforceable) and "liquidated damages" clauses, which are enforceable provided that the specified sum is "a genuine pre-estimate of loss".

El Makdessi and ParkingEye noted that the Dunlop tests had been applied too rigidly, particularly in cases where there is a clear commercial justification for including a penalty clause, or where there may be interests beyond the compensatory which justify the imposition on a party in breach of an additional financial burden.

3.2 What were the cases about?

The El Makdessi case related to the sale of a Middle Eastern media business and the provisions of a share purchase and shareholders' agreement. This was a major, multi-million pound commercial agreement and was heavily negotiated with lawyers acting for both sides. The agreement provided that if the seller was in breach of certain non-compete restrictions, then he lost his entitlement to deferred consideration. The Court of Appeal held that these provisions were penal, as their purpose was to deter an act rather than to compensate the loss suffered by the innocent party.

The ParkingEye case related to a parking fine of £85 imposed after a driver overstayed the two-hour limit in a privately-run car park. The Court of Appeal granted Mr Beavis permission to appeal, and it is testament to the integrity and impartiality of the English court system that the Supreme Court gave such a detailed judgment on a case involving an £85 fine.

3.3 The new test

The Supreme Court's judgment has moved the law on contractual penalties away from the narrowly applied tests in Dunlop. Lord Hodge re-cast the test as follows: "correct test for a penalty is whether the sum or remedy stipulated as a consequence of a breach of contract is exorbitant or unconscionable when regard is had to the innocent party's legitimate interest in the performance of the contract".

In El Makdessi, the Court concluded that the provisions in the agreement protected the buyer's legitimate interest in enforcing the non-compete restrictions so that the goodwill of the business was protected. The goodwill of the business was critical to its value to the buyer. The provisions therefore did not go beyond protecting the buyer's legitimate interests.

In ParkingEye, it was clear that whilst the £85 charge may have been perceived understandably by users of the car park as a deterrent from over-staying the two-hour limit, there were legitimate commercial interests that it was seeking to protect. These included preserving the traffic management system and efficient use of parking space and their users by deterring long-stay parking. The charge was also relied upon to run the scheme. As a result, the charge was held not to be "out of all proportion" to those interests and therefore not penal.

The Supreme Court judgment in respect of El Makdessi also referred to the importance of considering the circumstances in which the parties entered into the contract – "in a negotiated contract between properly advised parties of comparable bargaining power, the strong initial presumption must be that the parties themselves are the best judges of what is legitimate in a provision dealing with the consequences of breach". This is relevant to franchise agreements, which can appear across this spectrum depending on whether it is an international deal, a domestic multi-unit or high value deal or a domestic business format unit franchise deal.

3.4 What's changed? Some practical implications

Provided that a contracting party can demonstrate that it is using a penalty clause to protect a legitimate interest and the penalty is not exorbitant or unconscionable, the following principles now apply:

- It is no longer necessary for the penalty to be a genuine pre-estimate of loss.
- A party relying on the penalty clause does not have to suffer a loss.
- The predominant purpose of a clause can be to act as a deterrent against a certain breach of contract.
- The penalty does not just have to be a specified financial amount. A party can, for example, withhold deferred consideration or require the transfer of certain property as the consequence for breach.
- Generally, parties have a greater freedom to contract for the consequences for breach.

3.5 What does this mean for English law franchise agreements?

Franchise agreements typically fall into two categories:

- those which are issued on a "take it or leave it" basis, which is common in domestic business format franchising, when the parties are not of comparable bargaining position and the franchisee may not even take proper legal advice; or

- those which are negotiated freely between well-advised parties of comparable bargaining positions, which is common in larger scale, often multi-unit domestic franchising and international franchising.

It therefore seems like a fair assumption that the greater freedoms conferred by the Supreme Court will have most impact on English law large scale domestic and international franchise agreements, as opposed to smaller scale domestic agreements.

Nevertheless, all franchisors have a number of legitimate interests to protect and contractual penalties can therefore play an important role in focussing the mind of the franchisee on the franchisor's key interests and the types of behaviours and breaches which cannot be tolerated. For example:

- Franchisors must protect the goodwill and reputation of the brand and the system, both for themselves and their other franchisees. The goodwill and reputation is essential to maintaining and attracting franchisees and customers to the business.

- Franchisors are vulnerable when a franchisee decides to leave the network, as each franchisee has the potential to become a direct competitor of the franchisor, having benefitted from training, support and access to know-how.

- Franchisors have a legitimate interest in maintaining a high degree of contractual power and discretion so that they can effectively monitor and police their franchise networks and introduce innovations into the system.

This judgment is welcome news for franchisors, who may have previously hesitated from including deterrents and specified financial consequences for certain breaches. There may be more scope now to charge penalties for repeated operational breaches, breaches of audit protocols and breaches of in-term and post-term covenants. The approach to franchise sales could also be revised in light of El Makadessi.

In terms of practical steps, franchisors should consider taking legal advice and reviewing carefully the terms of their template agreements with a view to:

- weaving in the thread of "legitimate interests" and linking it to certain standards of performance

- including more financial consequences for certain breaches

- reviewing restrictive covenants and franchise sale provisions in light of El Makadessi

- replacing references to "genuine pre-estimates of loss"

4. Employment law issues – franchising and the gig economy

The ongoing expansion of the online marketplace is driving incredible growth of the so called "gig economy", in which large numbers of individuals now earn their living.

Companies like Uber suggest that they act purely as online intermediaries between consumers and those willing to provide services, individual drivers who in Uber's view are independent contractors in business in their own right, choosing when and where to work. But currently such individuals have very little say on the terms and conditions governing their engagement, and some may work long hours for low returns.

In the UK, the GMB union, a general trade union in the UK with over 631,000 members, successfully challenged Uber's stance, finding agreement from the Employment Tribunal that Uber drivers should in fact be regarded as legally protected "workers", with rights to holiday and the minimum wage.

Similar judgements have followed in the last 12 months, including in favour of a specialist medical cycle courier for CitySprint, and a tax tribunal case, in which the tax tribunal held that 13.8% employer National Insurance Contributions ("**NICs**") where due in relation to a 'self-employed' driver. The GMB union has also launched legal action on behalf of couriers for delivery companies.

4.1 What is employment status and how is self-employed status determined under English law?

Under English law, there are three possibilities for an individual's status: either:

(a) self-employed contractor;

(b) employee; or

(c) worker.

The distinction between the three categories is significant; employees benefit from numerous statutory protections under English and EU law, and at the opposite end of the spectrum are self-employed independent contractors, who do not have any meaningful employment rights, other than under health and safety and discrimination laws. In addition to the lack of statutory rights, the self-employed model also has significant tax / cost advantages, as a company does not have to pay any NICs in respect of self- employed independent contractors.

"Workers" fall in between these two extremes, and they are entitled to a number of the same protections as an employee, such as national minimum wage, paid annual leave, rights to pension contributions, maximum working week and the right to join a trade union.

Identifying employment status is a balancing act and all the circumstances must be taken into account. Three core factors which all together indicate an employment relationship and therefore undermine self-employment status are:

(a) Is the individual obliged to perform the service personally?

(b) mutuality of obligation – if there is work to be done, the individual must do it; and

(c) the level of control over place of work, hours, supervision..

But, additional factors can support self-employed status, including where the individual:

(a) provides and maintains his own tools or equipment

(b) hires his own help

(c) takes on some financial risk and investment

(d) has the opportunity to profit from his own good performance

(e) is not paid a fixed wage or salary

(f) is not paid when absent due to holiday or sickness

4.2 What did the Uber and CitySprint cases say?

In the Uber case, the Tribunal held that Uber resorted to "fictions" and "twisted language" in its documentation to compel agreement with its view of being an online intermediary rather than a transportation service. The Tribunal held that the "notion that Uber in London is a mosaic of 30,000 small businesses linked by a common 'platform'" is "faintly ridiculous".

In the CitySprint Case, the Tribunal recognised that Margaret Dewhurst, a medical cycle courier, operated as a "worker" with a right to receive holiday pay despite her signing up to terms and conditions as a self-employed contractor who could "provide a substitute to perform any particular Job". It found that she was obliged to personally work for CitySprint and that she:

(a) had no discretion in determining the manner in which she performed her work (e.g. she had discretion to determine her cycle routes but was otherwise fully trained to meet particular requirements);

(b) was incentivised to wear branded goods in a way that was akin to requiring uniform;

(c) could not, in practice, get somebody to substitute for her in the event that she could not carry out a job (e.g. somebody else could not use the hospital ID required to make deliveries and it would have been a breach of CitySprint's contract as a supplier to allow Ms Dewhurst to provide a substitute); and

(d) had no ability to improve her business opportunities by her own endeavours (e.g. work was allocated and defined by controllers in a defined working pattern).

As with Uber, the judge commented that CitySprint's recruitment procedure and working patterns were not consistent with its contract.

Uber has yet to change its model and is in the process of appealing the decision. It is important to remember that Employment Tribunal rulings in the UK do not have the same weight as the decision of a higher English court, so Uber may be wise to be cautious in taking this further at all – the GMB would be delighted to achieve a binding judgment for drivers across the UK.

4.3 How does this impact on franchising?

For businesses which already franchise, and particularly for those franchise systems which operate with a low entry threshold like contract cleaning and other service based franchises, such as domiciliary care and delivery services, these developments present a significant legal, reputational and financial risk to their business models.

Franchisors and franchisees alike may face challenges from individuals who are engaged to supply products and services to customers under the self-employed model. In addition, it is conceivable that franchisees themselves may also be able to claim worker or employee status in relation to their franchisor. If found to be on the wrong side of the law, it is likely that these businesses will need to factor

in higher operational and support costs (such as paying to top-up on the minimum wage for hours not guaranteed and expanding their back office HR support). Such costs may need to be passed on to the end customer. There is also the risk of having to manage potentially negative PR on the use or misuse of these models.

Conversely, for businesses which operate in this sector but which do not use the franchise model, franchising can be deployed to reduce current and future liability arising from the self-employed model and improve profitability, performance and brand recognition. Converting self-employed individuals or workers into genuine franchisees may result in greater professionalization of the service and an opportunity to cultivate the entrepreneurial energy of franchising to drive new business opportunities and innovations in the operational systems.

In the short term, it may be possible to find ways around the Uber ruling, such as by requiring a self-employed individual to pay an upfront fee in order to provide a service at a location and earn money from its clients – the case in point being an earlier Court of Appeal decision which concerned a dancer at the night club Stringfellows.

However, such measures may only be useful in very limited circumstances and may only provide a temporary solution, as the direction of travel has been set. In October 2016, the UK Prime Minister established an independent review to consider and advise on whether employment regulation and practices are keeping pace with the changing world of work. The "**Taylor Report**" is due to publish its recommendations in June this year, and it is likely in the coming months and years that employment and related tax law will be revised to (i) draw a clearer distinction between the different types of employments, (ii) ensure that there is a re-distribution of risk between the employer and the worker, and (ii) protect the UK Government's tax revenue.

Some practical recommendations include:

(a) Carrying out an audit of your delivery models and the supporting HR policies and contracts to ensure that they are consistent.

(b) Where changes are required, carry out financial planning to ensure that the franchise model is still economically viable for both parties, or for businesses which do not franchise, consider deploying the franchise model.

(c) Considering introducing restrictions and indemnities in franchise agreements to prevent or discourage the use of self-employed models which are likely to fall foul of the law.

Conclusion

New technology is undoubtedly assuring the growth of the gig economy, but the future of workers' rights remains uncertain. Franchise systems and companies operating in this sector should be looking carefully at their models and ensure that they have suitable contracts and policies in place and use a model which fits their business objectives.

These cases are likely to continue as battles in a long war, which is already being fought in many different countries.

5. Large business payment practices

For larger businesses, the introduction of the Payment Practices and Performance Regulations 2017 will require, as of financial years beginning on or after 6 April 2017, large businesses to report publicly twice yearly on their payment practices and performance, including the average time taken to pay

supplier invoices. The reports must be published on an online service set up by the government and available to the public.

The aim of the new reporting requirement is to increase transparency and public scrutiny of large businesses' payment practices and to give small business suppliers better information to make informed decisions about who to trade with, negotiate fairer terms, and challenge late payments.

5.1 Which businesses are required to report?

UK registered companies and limited liability partnerships (LLPs) will be subject to the new reporting requirement if they qualify as medium-sized or above for accounting purposes, that is, they exceeded two or all of the following thresholds on both of their last two balance sheet dates:

- Over £36 million annual turnover
- Over £18 million balance sheet total
- Over 250 employees

Smaller businesses will not be caught, whether or not their shares are traded on any stock exchange.

Parent companies and LLPs will be caught if their group qualifies as medium-sized or above for accounting purposes and they also meet the definition above in their own right. Each group business which meets the definition will be required to publish its own individual and non-consolidated report.

Independent franchisees (i.e. where there is no franchisor shareholding) will not form part of a franchisor's group for the purposes of these thresholds.

5.2 What must be reported?

The reporting obligation applies to payment practices in relation to business to business contracts for goods, services or intangible assets (including intellectual property). Business to consumer contracts are not covered and contracts for financial services are also excluded. Contracts will also have to have a significant connection with the UK to be covered by the duty to report.

To discourage stalling tactics, disputed invoices will not be excluded.

The report must include narrative descriptions of:

- the business's payment terms, including: standard contractual length of time for payment of invoices, maximum contractual payment period and any changes to standard payment terms and whether suppliers have been notified or consulted on these changes
- the business's process for dispute resolution related to payment

It must also include statistics on:

- the average time taken to pay invoices

- the percentage of invoices paid within the reporting period which were paid in 30 days or fewer, between 31 and 60 days, and over 60 days

- the proportion of invoices due within the reporting period which were not paid within agreed terms

There must also be tick-box statements about:

- whether the business offers e-invoicing

- whether the business offers supply chain finance

- whether the business deducts sums from payments as a charge for remaining on a list of preferred suppliers, and whether it has done this in the reporting period

- whether the business is a signatory to a code of practice or standards on payment practices, and the name of the code

A company director should be responsible for signing off the report – for an LLP, the equivalent is a designated member.

5.3 When must reports be published?

The first report will be due 30 days after the end of the first six months of a business's financial year, and the second report will be due 30 days after the end of the financial year. Where a business changes its year end and has a financial year of or below nine months, it will be required to report only once after the end of that financial year. If a change to the year end results in a financial year of over 15 months, the business will be required to report after each of the first and second six months of the financial year and in respect of the remainder of the financial year.

5.4 Sanctions

It is hoped that publicity, public pressure and good payment behaviour by responsible companies leading the way will encourage compliance with the new reporting requirement and lead to improvement in payment practices. In addition, failure to publish a report is a criminal offence, with the company and directors liable to a fine on summary conviction. It is also an offence to publish false or misleading information and a company or individual who does so will also be liable on summary conviction to a fine. Guidance to help businesses understand and comply with the new reporting requirement has been published.

For larger Franchise businesses, it will be critical to undertake a review of contracts and payment performance metrics to ensure that these obligations, and such reporting requirements, where applicable, are complied with.

6. A New Code of Ethics for Franchising in the UK

The European Franchise Federation ("**EFF**") recently adopted a new version of the European Code of Ethics for Franchising ("**Code of Ethics**"), the first update for 13 years. The British Franchise Association ("**BFA**") and the EFF's other accredited national franchise association are now in the process of interpreting and adopting the updated Code of Ethics into their national equivalent codes.

6.1 Introduction

The EFF is the non-profit international association set up in 1972 to govern and oversee the franchising industry in Europe. The Code of Ethics is designed to promote ethical franchising in Europe and provides the franchise industry's foundation for voluntary self-regulation. The updates to the Code of Ethics follow a process of bottom-up industry consultation, negotiation and agreement by the franchise stakeholders/companies and members of their respective national franchise associations.

The BFA is the EFF's accredited national franchise association for the UK and the BFA voted in favour of adopting the latest version of the Code of Ethics at its Annual General Meeting on 8 December 2016. The BFA is now working on updating its national Code of Ethics accordingly,

6.2 Why now?

Despite being part of a single market, there is a lack of harmonisation in the way in which member states regulate franchising in the EU. Some stakeholders are of the opinion that franchising is failing to fulfil its full potential in the EU and this is due, at least in part, to the lack of a homogenous approach to regulation, the adverse impact of EU competition law on franchised brands and a failure of self-regulation to adequately promote, educate and support franchising at a member state level. On the other side of the debate are those who remain in favour of self-regulation, pointing to high rates of satisfaction among franchisees, the continual (albeit slow) growth in franchising's share of EU GDP and low failure rates.

Advocates of these opposing views came together recently at a workshop hosted by the European Parliament, following the publication of a report into the state of franchising in the EU, which was commissioned by the European Parliament's Internal Market and Consumer Protection Committee. The report recommended the introduction of a new EU Directive for franchising which, if implemented, would effectively do away with the self-regulatory approach that has prevailed for the last 5 decades. After 13 years, the Code of Ethics was arguably due an update in any event, but the timing of the updates is important to those who continue to advocate the status quo of self-regulation.

At a national level, the BFA has responded to criticisms made by UK Government in the wake of the recent "Pubs Code" in 2016 by looking to introduce a mandatory arbitration scheme to deal with disputes between BFA franchisor and franchisee members.

6.3 What's new?

(i) *Good faith and fair dealing*

There is clear recognition in the Code of Ethics that the franchisor/franchisee relationship should be underpinned by the principles of good faith & fair dealings. Both are expressly included in the preamble to the Code of Ethics, which emphasises the importance of franchisor-franchisee relations based on fairness, transparency and loyalty, each of which contribute to confidence in the relationship. Furthermore both franchisor and franchisee:

- must commit to resolving complaints, grievances and disputes with good faith and goodwill through fair and reasonable direct communication and negotiation;
- where appropriate and where they have failed to resolve a dispute through direct negotiation, must seek in good faith mediation and/or arbitration to resolve the dispute.

The English law of contract is well known for not having a general duty of good faith and the approach to dealing with good faith situations in case law has been piecemeal, in line with the general development of common law. One of the main reasons advanced for this is the uncertainty which would arise if a general duty of good faith was imported into contracts generally. English law is at odds with some other common law jurisdictions which have been moving towards recognising a general duty of good faith, and in the last few years similar arguments have been advanced in the English Courts, albeit with very limited success. The fact that the Code of Ethics is embracing the general principle of good faith and fair dealing should cause BFA members to pause for thought - they should consider carefully what this concept means in the performance of their franchised systems and take steps to reflect this understanding and the limits of this concept in their respective franchise agreements.

With regards to dispute resolution, the BFA intends to introduce mandatory arbitration as a condition of membership and it is currently drafting the arbitration scheme rules, although the scheme has yet to be formally adopted. This is a significant issue for BFA members and prospective members to consider carefully, as once adopted the scheme will limit a franchisor's or franchisee's access to the English courts.

(ii) ***Obligations for franchisors***

The Code of Ethics sets out a list of obligations for franchisors. The reality is that most of these obligations are not new ones and were present in the previous version of the Code of Ethics, such as the obligation for franchisors to have tested a pilot concept for at least one year and provide franchisees with initial and ongoing training. There are, however, some new requirements, such as those obliging a franchisor to:

- guarantee the right to use the know-how transferred and/or made available to the franchisee, which know-how it is the franchisor's responsibility to maintain and develop. Interestingly, know-how is also defined in the Code of Ethics as a body of non-patented practical information, resulting from experience and testing by the Franchisor, which is secret, substantial and identifiable. This is an interesting addition to the Code of Ethics, particularly in light of recent case law in key franchise jurisdictions such as Canada, where franchisees have successfully sued their franchisor for failing to protect their businesses from innovative competitors;

- in the pre-contractual, contractual and post-contractual phases of their relationship with franchisees, to use all reasonable means to prevent any wrongful usage of or, in particular, the transmission of know-how to, competing networks so as to avoid prejudice to the interests of the network. In the new age of cyber-crime, it is increasingly important for franchisors to ensure that they are investing in appropriate safeguards to protect trade secrets and confidential information;

- offer to their franchisees an unqualified right to sell or transfer their business as a going concern; and

- to inform prospective and individual franchisees of their internet communication and/or sales policy. It is no longer acceptable for some franchisors to hide behind the opaque pretence of "prior written consent" before a franchisee is allowed to participate in online activities. Franchisors must develop and communicate transparent policies in this regard and also seek to safeguard the interests of the network in the development of their online sales policy.

(iii) ***It's not all one way traffic - obligations for franchisees***

The Code of Ethics also imposes various obligations on franchisees. Many were present in the previous Code of Ethics although there are new requirements including that franchisees shall:

- accept the obligation to collaborate loyally with the Franchisor in ensuring the success of the network which the franchisee has joined as an informed and fully independent entrepreneur. This is an important addition to the Code of Ethics because it emphasises the fact that although the relationship between franchisor and franchisee is of paramount importance to the success of a franchise, any prospective franchisee is independent from the franchisor as a separate legal entity and in turn it must take a significant degree of responsibility for the success of its business;

- be responsible for the human and financial means that it engages in its franchise business and is responsible as an independent entrepreneur with regard to third parties and B2B and B2C customers; and

- act loyally towards each of the other franchisees of the network. This addition emphasises the importance of each franchisee's individual role in preserving the strength of the network by acting together, such as through sharing ideas that might enhance the franchised system.

6.4 Conclusion

The updated Code of Ethics aims to address some of the perceived imbalances and inequities in the franchise relationship and bring self-regulation into the digital age. However, although the BFA's interpretation of the Code of Ethics may include some variations from the EFF's text, much of the BFA's existing Code of Ethics and its practices are already in line with these updates.

Given the 13 year wait and the rapid advances which have been made in the way in businesses sell their products and services during this time, it is arguable that the updated Code of Ethics does not go far enough, either in bringing more clarity to issues it has sought to address and also pre-empting how franchising might change in the next 13 years or more.

It remains to be seen whether the voices calling for the regulation of franchising will grow louder, but if the self-regulatory system is to survive, we suspect that that we may not have to wait so long for the next round of updates.

7. Biography

Gordon is a partner in the franchising and commercial group at Fieldfisher, a full service European law firm.

Gordon advises clients across a wide range of sectors, from start-ups to blue chip companies, on their domestic and international expansion through franchising, licensing and other routes to market, such as e-commerce, concessions, agency, distribution, joint ventures and strategic alliances.

Gordon is ranked in Chambers, The Legal 500 and Who's Who: Franchise 2016 for his expertise in franchising. Fieldfisher's franchising and commercial team is top ranked by the legal directories in the UK and also by Chambers Global for its pedigree in international work.