

Manzoor Ishani, senior consultant solicitor with Sherrards, discusses the key areas that businesses should consider when planning to franchise

## **FRANCHISING; DISTRIBUTORSHIPS; AGENCY – WHAT’S THE DIFFERENCE?**

For anyone wishing to grow their business, there are a number of different methods by which they can achieve their objective. Commerce has moved on from the early days of barter and straightforward buying and selling. As markets expand, so the methods of conducting business become increasingly sophisticated. Anyone wishing to sell goods/services via a third party (thereby hoping to penetrate a market more quickly and efficiency) now has a number of marketing methods to choose from.

How then does one distinguish amongst them? The first important thing to remember is that they are all methods, essentially marketing methods, of doing business.

### **Agency**

In strict legal terms, an agent is someone who acts for and on behalf of the one who appoints him and who is called the "principal". What the agent does is to represent his principal in a commercial transaction. The important point to note here is that as the agent represents the principal, he binds the principal and therefore the principal is liable for the acts, omissions and defaults of his agent. The agent, in effect, acts with the authority of his principal. The fact that the terms of his appointment restrict the agent's authority will not necessarily save the principal from liability if the person dealing with the agent does not know of the limits placed on the agent's authority or if the agent "holds himself out" as having such authority or if in certain circumstances, it is reasonable for the person dealing with the agent to assume that agent has the necessary authority. By virtue of agency, the seller contracts directly with the customer, who is the seller's customer, not that of the agent.

So an agent who sells goods will not own them. It is the principal who owns the goods and it is the principal who sells the goods to the customer via his agent. The agent is therefore merely an intermediary.

### **Distributorship**

It is clear that while an agency has a number of advantages, it is not without its limitations. A more sophisticated way of doing business is in the form of a distributorship. Whereas the agent acts for and on behalf of its principal, a distributorship acts for himself.

Unlike an agency where the seller contracts directly with the customer, in a distributorship this is not the case. Put in its simplest form, in a distributorship the distributor buys the goods from his supplier and sells them on to the distributor's customer. There is a moment in the buying and selling chain when the distributor becomes the owner of the goods in question. Furthermore, a distributor does not bind his supplier in the way that an agent binds his principal. Also generally speaking (with the exception of matters relating to product liability which are dealt with separately by legislation) if there is a problem, the distributor will be held liable for his acts, omissions and defaults.

### **Know-how and other Licences**

So far as such licences are concerned, this is nothing more than a legal term meaning the grant of a right. Thus agencies, distributorships, dealerships and franchises are all technically licences because they all involve the grant of rights by one party to another. Such licences may include manufacturing rights, selling rights, rights to use trade marks, logos, copyright and soon.

## **Business Format Franchise**

From distributorships grew the development of business format franchising.

Business format franchising is the concept of licensing an entire business package (comprising all the elements necessary to establish a previously untrained person in a business which has been proven to be successful) to be run on a predetermined basis.

The European Franchise Federation defines franchising as a system of marketing goods and/or services whereby the franchisor grants its franchisees the right, and imposes the obligation, to conduct a business in accordance with the franchisor's concept.

This right entitles and compels the franchisee, in exchange for a direct or indirect financial reward, to use the franchisor's trade name, and/or trade mark and/or service mark, know-how, business and technical methods, procedures, system, and other intellectual property rights, supported by the continuing provision by the franchisor to the franchisee of commercial and technical assistance, within the framework of a written franchise agreement. In its Block Exemption Regulation for Franchising (which has now expired) the European Commission defined a franchise as "a package of industrial or intellectual property rights relating to trade marks, trade names, shop signs, utility models, designs, copyrights, know-how or patents, to be exploited for the resale of goods or the provision of services to end users."

It defined a "Franchise Agreement" as "an agreement whereby one undertaking, the franchisor, grants the other, the franchisee, in exchange for direct or indirect financial consideration, the right to exploit the Franchise for the purposes of marketing specified types of goods and/or services; it includes at least obligations relating to:

- The use of a common name or shop sign and the uniform presentation of contract premises and/or means of transport.
- The communication by the franchisor to the franchisee of know-how.
- The continuing provision by the franchisor to the franchisee of commercial or technical assistance during the life of the agreement."

From this definition it is clear that the following basic features must be present in every "business format" franchise:

- (i) There must be a contract between the parties which sets out all the terms.
- (ii) The grantor of the franchise ("franchisor") must introduce the franchisee to and train him in all aspects of the franchise business prior to his opening his business and assist the franchisee in its opening.
- (iii) Once the franchisee's business has opened and is trading the franchisor must continue to support the franchisee in all aspects of operating that business and maintain an interest on a continuing basis in his franchisee's business.
- (iv) The franchisor must permit the franchisee to operate the business under the trade name, format and or business system of the franchisor, albeit under the control of the franchisor, and permit the franchisee to benefit from the goodwill of the franchisor's trade name, etc.
- (v) The franchisee must own his own business and make some capital investment in that business.
- (vi) The franchisee must pay the franchisor on a continuing basis for the right to use the franchisor's business system, trade marks, etc. and for the ongoing support and services which the franchisor is required to provide the franchisee.

Thus the business format franchise is a stage in the evolutionary development of agency, distributorship and know-how type of licence. Instead of being limited to one aspect of business activity there has developed the concept of licensing an entire package comprising all the elements necessary to establish a previously untrained person in a business to be run on a pre-determined basis.

## **Comparison**

When one compares a business format franchise with some of the methods referred to above, a number of similarities and differences emerge.

**Agency** - this is one aspect of doing business which is absent from most business format franchises. Indeed, franchisors go to great lengths to explain to franchisees and make it a contractual term that the franchisee is not the agent of the franchisor and should not hold himself out as being one. The fact that the franchisee bears the franchisor's name need not of itself make him an agent of the franchisor.

**Distributorship** - there is a great deal in common between a distributorship and a business format franchise and increasingly less that is uncommon. There are a number of distinguishing features which differentiate a business format franchise from a distributorship. For example: It is common in distributorships for distributors to have more than one distributorship within the same business. In a business format franchise this is generally not permitted. Most franchisors insist that franchisees devote their full time and attention to the franchise in question, do not undertake any other business activity and do not take on any other franchises. Distributorships are generally granted to those who have prior knowledge and experience in that particular line of business and who for the most part have been running their own businesses. Franchisors, on the other hand, take an entirely different view. Many franchisors go so far as to refuse to grant franchises to those who have been in the same line of business before. The reason for this is their belief that they have a much greater chance of succeeding with someone who comes to them with a clear mind and who can therefore be moulded into operating a particular business in the franchisor's particular way. Franchisors claim that franchisees who come to them with prior knowledge of their type of business are more difficult to train and have greater difficulty in retaining the training they receive than those who have no prior experience or knowledge in the field. Also, unlike distributors, most franchisees have been employees in their former working life and have never run a business on their own account.

**Know-how and other licences** - a business format franchise is clearly a licence and to the extent that licences apply to intellectual property, franchise agreements incorporate a grant of licences by a franchisor to the franchisee to use the franchisor's intellectual property.

From the foregoing it should become apparent that any label attached to a particular contract should not be taken at face value. They may be distributorships which are being passed off as business format franchises and vice-versa. The important thing is to look beyond the label and at the substance of the transaction contemplated. It has to be said that the distinction between a distributorship and a business format franchise is not always easy to determine. However, care does need to be taken in making the necessary distinction because it is quite possible that there are less than genuine reasons for labelling something as a distributorship when it is not and vice-versa.

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