Franchising in Nigeria:
Models and Legal Considerations

Thought Leadership | By Frank Okeke (Originally published in *BD Legal Business, 5.6.2018 p. 29*)

f.okeke@lelawlegal.com

Introduction

In our current economic clime with the growth of consumerism, markets for goods and services have become increasingly globalised with the coming of age of information technology. Franchising provides a means of expanding a business' reach into new markets, new products and access to a wider customer base without the need for extensive capital investment. We will discuss the various models before delving into legal/regulatory/commercial considerations.

Franchising Models

Master Franchising
Under this model, the franchisor (Master Franchisor) grants a third party (the Master Franchisee) the right to operate the business in a given territory, vide a Master Franchise Agreement (MFA). The Master Franchisee is referred to as such because it has the right to grant "sub-franchises" to third parties within that territory whilst also receiving franchise fees from subsequent franchisees. The Master Franchisee effectively becomes the franchisor for that territory, operating the business and recruiting, training and managing a network of sub-franchisees.

The franchise fees obtained and other ancillary fees obtained from the sub-franchisees may be split between the Master Franchisor and the Master Franchisee, or the Master Franchisee could have a specific franchise fee obligation irrespective of the fees received from sub-franchisees.

Direct Franchising
In this arrangement, the franchisor grants a third party the right to operate a single item business, rather than the right to open multiple outlets in a territory as in the multi-unit Developer Franchising or the Master Franchising model. This may be appropriate where the concept is not suited to multiple units (e.g. retail, quick service restaurants etc.), or where a franchisor prefers to have a direct relationship with each franchise operator in a territory.

Multi-unit Developer Franchising
Here, the franchisor grants a third party the right to exploit a designated territory by opening multiple outlets. There is need for the third party franchisee to have considerable financial resources in order to fully cover the territory being granted by the franchisor. This structure is commonly used in retail franchising.

Management Franchising
This structure is more common when the developer has sufficient capital to invest in establishing the brand in a given territory, but does not have access to the depth of operational expertise and resources required to help ensure its success in that market. The developer obtains the right to operate an outlet(s) at the location but will engage a management company to operate the business on its behalf, which could be an affiliate of the franchisor. This structure is very common in the hotel and leisure sector.

Legal Considerations

Whatever model is adopted, the franchise attorney must ensure that strategies are put in place (dependent on the party he represents) for the efficient operation of the franchise.

Brand Protection

Businesses should invest prudently to ensure that each target market will be underpinned by registered trademarks, patents, design rights (if appropriate) etc. Intellectual Property is usually never in perpetuity and the franchisor must ensure that a mechanism is put in place for renewals. ***Section 23 Trademarks Act, Cap. T13, LFN 2004***, for instance provides that the registration of a trademark shall be for a period of seven years, but may be renewed from time to time. Patents, on the other hand have a limited term. ***Section 7, Patents and Design Act, Cap. P2, LFN 2004*** provides that the term of a patent shall be twenty years from the filing date of the application.

Real Estate-Franchise Lease

It is important for the lease and franchise term to be synchronized. A key issue that could arise, where the terms do not align is that a franchisee may be left with no premises from which to operate or the franchise term ends but the lease term is still operational. Both of these scenarios are not only uncomfortable but can mean unnecessary financial exposure for franchisees.

In sorting out the real estate factor in franchising, there are two usual outcomes: either the franchisor or the franchisee holds the lease. The franchisor holding the lease is a more straightforward arrangement because at the end of the franchise relationship, the franchisor simply recovers the premises from the franchisee (tenant). It should be noted that by holding the lease, the franchisor is primarily liable if the franchisee is in default of its ('sub-tenant') obligations.

Where the franchisee is to hold the lease, the franchisor may assist the franchisee to locate a suitable property and negotiate with the lessor to secure: competitive rent; rent-free period; and other incentives, for the franchisee. This could be key in enhancing the profitability prospects of the franchise, especially in the start-up period. Many franchisors provide this service and even charge the franchisee an additional fee as part of their franchise package. Depending on the circumstances, it may be prescient for the franchisor to obtain an acknowledgment from the franchisee stating that the franchisee has: (1) conducted its own due diligence concerning the premises, (2) satisfied itself that the location is suitable; (3) entered into the lease as a result of its assessment of the premises; and (4) not relied on any representations or statements from the franchisor regarding the suitability of the premises. This is in order to reduce potential exposure for the franchisor.

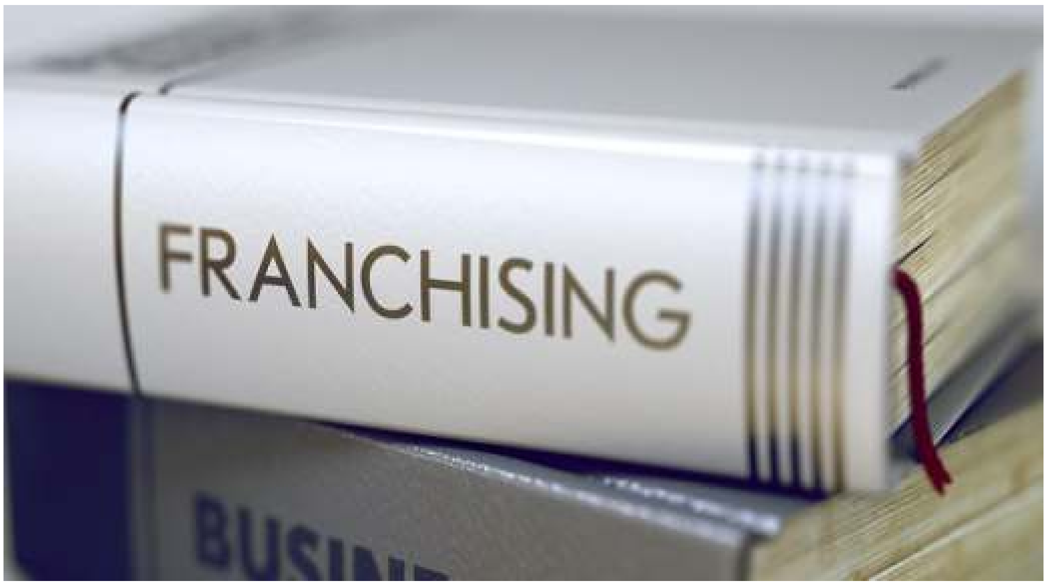
With the franchisee as lease holder, the franchisor has no control of the premises, should the franchisee exit the franchise relationship. This could result - if the franchise agreement omits to preclude it – in the erstwhile franchisee deciding to remain in occupation of the premises under a different brand. In order to avoid this, the franchisor can insist on a clause in the franchise agreement stating that upon termination of the franchise relationship, the franchisor be granted the right to 'step into the shoes' of the franchisee in respect of the lease. This clause would be useful where the franchisor wants to retain possession of the premises due to its strategic location marketability, customer target and range etc.

Restraint of Trade

It may be necessary for the franchisor to include a trade restraint clause at the determination of the franchise relationship. This is to ensure that the franchisee is unable to use trade secrets garnered from the franchisor to operate as a competitor within a certain period. In Nigeria, the courts have held that trade restraint clauses are enforceable as long as same are reasonable. In ***Koumolis v Leventis Motors Limited [1973] NSCC 557, the Supreme Court (SC)*** held that it is the role of the employer who seeks to enforce the restraint clause against the employee to show that the clause is designed for the protection of some exceptional proprietary interest of the employer and it is reasonable for such purposes. It went further to hold that an employer can lawfully prohibit the employee from setting up a competing business, or accepting a position with one of the employer's competitors, so as to be likely to destroy the employer's trade connection by a misuse of his acquaintance with the employer's customers or clients.

Labour Issues

A clause should be included stating that the franchisor cannot directly control the franchisee's employees, including hiring or firing them. This is particularly important as globally, there is an ongoing debate as to whether the franchisor can be held jointly liable with the franchisee in the event of a breach of labour laws. Joint employer liability means the franchisor is jointly and severally liable for any labour or employment law violations committed by its franchisees (e.g. unpaid wages, unpaid benefits, minimum wage violations, anti-unionization activity, non-deduction/remittance of employee taxes etc.).



In Australia, the ***Fair Work Amendment (Protection of Vulnerable Workers) Act 2017 (FWAA)*** was passed to protect employees by extending potential liability to franchisors for employment law breaches by franchisees. The liability is not automatic, but will arise where the franchisor *"knew or could reasonably be expected to have known that the contravention by the franchisee entity would occur, or a contravention of the same or similar character was likely to occur"*, subject to a defence that the responsible franchisor employed reasonable steps to prevent the breach ***(section 558B FWAA)***.

Co-employment refers to a situation where an employee would be regarded as being employed by two employers any one of which may be bound by the terms of the contract of employment, and where each party has duties and obligations as an employer towards the employee. The principle of co-employment has been recognised by Nigerian Courts. For example, in ***Onumalobi v. NNPC & Anor. [2004] 1 NLLR (Pt. 2), 304***, the SC held that the two Respondents were co-employers of the Appellant, relying on ***section 91 Labour Act Cap L1 LFN 2004 (LA). Section 91 LA*** defines an employer as ***"any person who has entered into a contract of employment to employ any other person as a worker either for himself or for the service of any other person…"*** The question whether two employers could be held to be co-employers in respect of an employee, will depend on the contract of employment and the surrounding circumstances.

Wright v. Mountain View Lawn Care, LLC Civil Action No. 7:15-cv-00224, was a case in the United States of America where an employee of a landscaping franchise could not show that the franchisor exercised enough control over her employment or that other factors suggested it should be held liable as a "joint employer" for the alleged unlawful acts of the franchisee. She relied on the franchisor's control over logos, uniforms, letterhead, and vehicle colour. However, the West Virginia Federal District Court explained that control over the franchisee was not relevant and it was control over the plaintiff's employment that mattered - which was lacking here.

Conclusion

Franchising is an important business tool; however it must be properly structured in order to deliver its anticipated economic benefits. In March 2018, the United States-based doughnut and coffee franchise, Krispy Kreme, opened its doors in Nigeria; it is being promoted by Quality Foods Africa Nigeria Limited (QFA). Master Franchising might be the most suitable model of operation in Nigeria in order to ensure rapid growth and expansion whilst retaining the high standards.

However, prospective parties must ensure they conduct their due diligence. Franchisors must ensure that adequacy of process to protect themselves from labour infractions committed by franchisees. Some of these include: franchisors limiting the level of training offered to franchisees; training should be limited to franchise owners and key employees with managerial authority; online training modules for lower level employees (if available) should be licensed to the franchisees, who in turn will provide the online training to their employees. Others are non-involvement in franchisee's employment or human resource related practices such as hiring, training, firing, disciplining, setting work hours, handling payroll, providing worker's compensation insurance, etc.

If job applications may be submitted through the corporate website, it should be stated clearly that they will not be reviewed by the franchisor but will simply be passed along to the appropriate franchisee. This is to ensure that the franchisor cannot be deemed an employer under ***section 91 LA.*** A well-structured franchise would reduce future disputes between parties as well as ensure that both parties' long term investment goals are met.

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