Franchising: A Pathway to Entrepreneurial Success In Nigeria

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INTRODUCTION

Franchising is a business model that businesses use to expand their brand and operational footprint. A franchisor is a company, business or person that has developed a system/name and grants a third party the right to operate a business under the system and name in consideration of fees from the third party. According to the International Franchise Association, a franchise is *"the agreement or license between two legally independent parties which gives: a person or group of people (franchisee) the right to market a product or service using the trademark or trade name of another business (franchisor); the franchisee the right to market a product or service using the trademark or trade name of another business."* The essence is to enable the franchisee enjoy commercial success in his business by 'riding on the coat tails' of the franchisor. There is usually a fee (the 'franchise fee' or royalty) attached to the use of the system.

There is a popular saying that owning a franchise allows you *to go into a business for yourself, but not by yourself*. The advantages of franchising include - access to an established product or service which already enjoys widespread brand-name recognition, effectively giving the franchisee the benefits of a pre-sold customer base which would ordinarily take years to establish, thereby significantly increasing his prospect of success. It provides franchisees with a certain level of independence where they can operate their business, and offer consumers the attraction of a certain level of quality and consistency mandated by the franchise agreement. The franchisee is willing to pay for association with time tested and trusted products and methods (which would otherwise take him years to create), through the franchise arrangement.

Some examples of franchises in the quick service restaurant (QSR) sector in Nigeria include: *Mr. Biggs', Domino's Pizza, Chicken Republic, Kentucky Fried Chicken (KFC), Debonair's Pizza, Tastee Fried Chicken (TFC)* and *Tantalizers*. Four of the above examples are homegrown Nigerian brands.

Structure and Construct of a Franchise Agreement

A franchise agreement (FA) by its complex and technical nature is accompanied by a bundle of Intellectual Property (IP) rights (trademarks, service names, patent, designs, technological know-how etc.), which are protected and regulated not only by the FA between the parties, but also by relevant laws regulating the transfer of such, especially where there are cross border dimensions. The IP rights are the basis upon which the FA is built because a franchisor would be unwilling to enter into an FA if it feels its IP rights would not be adequately protected.

Issues can arise regarding the impact of a franchisor's bankruptcy or liquidation on the FA and its resultant effect on the franchisee. What would be the fate of the IP rights *vis-à-vis* the franchisee's interest? If a liquidator is appointed over the franchisor company, the liquidator takes control of the company and can enforce its rights against franchisees. The franchisee must continue to pay the agreed fees and adhere to the franchise system.

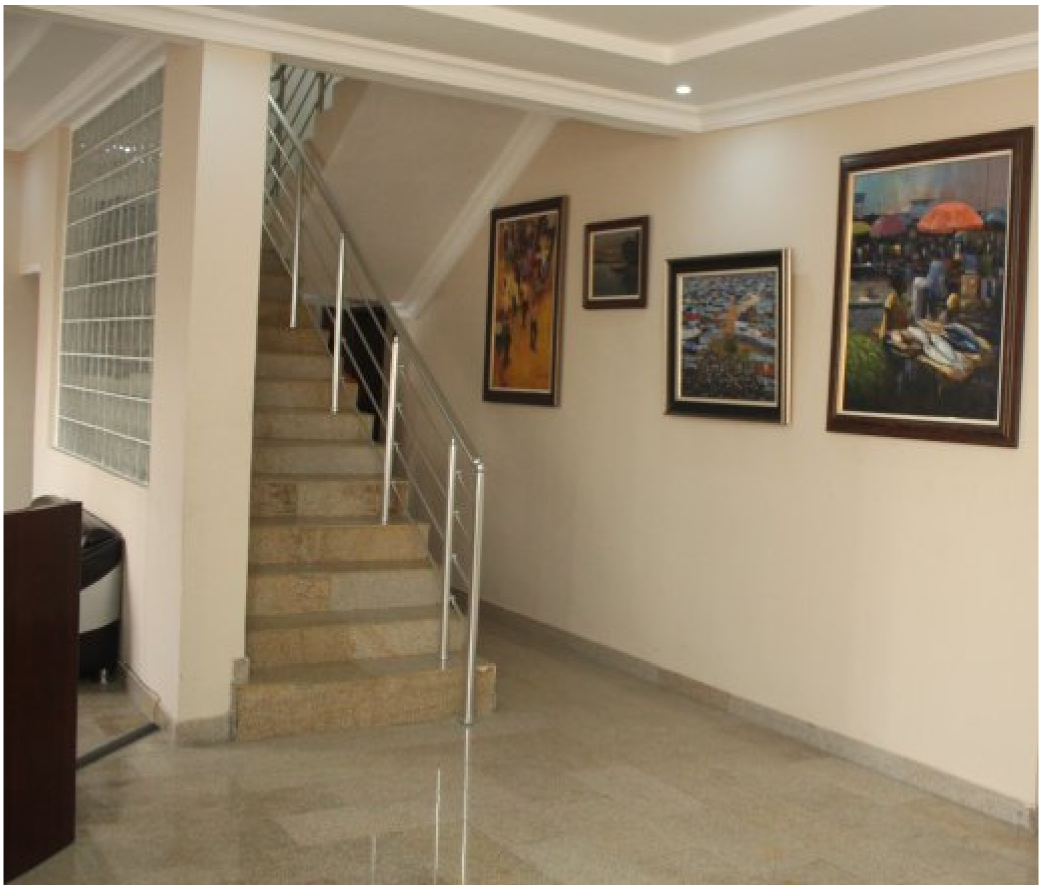
The role of the Liquidator would be to sell the franchisor company to a third party or in the alternative sell the assets of the franchisor which includes the IP rights. If the franchisor company is sold to a third party (which is more preferable), then the FAs could be assigned to the new owner and the franchisees can continue to do business as usual. On the other hand, if the assets of the franchisor are sold, nothing prevents the franchisee(s) from acquiring the IP Rights. It must be stated that an FA does not terminate simply because the franchisor has gone into liquidation. This is however subject to the express terms of the Agreement.

Franchise lawyers spend a considerable amount of time drafting and negotiating FAs, since the FA is the cornerstone of the franchise relationship and is likely to be in place for a number of years. While no two FAs may be identical, most include provisions such as the grant of a trademark license, the right to operate the franchised business, payment of fees, terms of the rights granted, limitations on how the franchisee can use the franchisor's trademarks, indemnity clauses, operational standards and specifications, reporting requirements, default, termination, post-termination obligations, non-compete clauses and disclosure of confidential information, and procedures for dispute resolution.

However, these clauses are subject to judicial interpretation. In Canada, the court recently held that a 'non-compete' clause in an FA may not be enforceable in all circumstances against the franchisee. A non-compete clause is a clause which estops a party from engaging in a business similar in nature to that which the particular agreement is centred upon. In an FA, these clauses are used to ensure that the franchisee does not, with the know-how obtained from the franchisor during the course of the relationship, operate a business which would be in unfair competition with the franchisor and other subsequent franchisees. However, a recent Canadian decision seem to suggest that the fact that there is a non-compete clause in a franchise agreement, does not make it enforceable. The Ontario Court of Appeal, in *MEDIchair LP v DME Medequip Inc, 2016 ONCA 168*, refused to enforce a franchisee's non-compete covenant because the evidence demonstrated that the franchisor did not intend to open a franchised store within the restricted territory.

The Court concluded that non-compete covenants must protect “the legitimate interest of the franchisor”, but cannot extend beyond that. In this case, the franchisee had de-identified its franchise and opened a similar business in the same location; however, because the franchisor did not intend to operate in the protected territory after the franchise relationship ended, the franchisor was found not to have the requisite legitimate interest to restrict competition by the franchisee within that territory. However, where a franchisee is declared to be in breach of these provisions, the franchisor can take out injunctions in order to protect its position. In the Nigerian case of ***Andreas Koumoulis v. Leventis Motors Limited, (1973) ALL NLR 789***, the appellant was sued for breach of his contract of service as spare parts Sales Manager. Clause 6 of the contract provided that the appellant shall not for at least a year, after leaving the employment of the respondent, operate a similar business as that of the respondent within a 50 miles radius from any trading station owned by the respondent. The Supreme Court affirmed the decision of the trial court and held that the clause was enforceable against the appellant.

Finally, as with any business relationship, there is a dispute resolution component to franchise arrangements. Franchise litigation lawyers typically deal with claims such as violations of franchise sales laws or franchise relationships laws, misrepresentations during the franchise sales process, failure to pay amounts due, failure to make required refunds, and failure to provide contracted support. Franchisors typically try to control litigation somewhat with contractual provisions that require the franchisee to submit certain claims to mediation or arbitration or require the franchisee to litigate only in a specific forum. In 2013, an Australian franchise, *Pie Face*, was on the wrong end of series of legal action from its franchisees for misleading representation about potential sales and profitability. In order to avoid litigation, it is essential that the franchisor and the franchisee clearly lay out the duties and obligations of both parties, warranties (if any) and expected timelines for the performance of the said duties.



Legal Framework for Franchising in Nigeria

Till date, there is no specific franchising legislation in Nigeria. However, it must be stated that there are several regulatory provisions, existing in bits and pieces that affect franchising in Nigeria. An example is the ***National Office for Technology Acquisition and Promotion (NOTAP) Act Cap. N62 LFN 2004*** which established NOTAP. It would however be erroneous to state that NOTAP Act is the regulatory Act for franchising in Nigeria. This is because NOTAP deals only with the transfer of technology from foreign entities. Arguably, if an FA was to be executed between local entities there would be no need for NOTAP registration. However, there are still some legal issues to be sorted such as trademark registration, incorporation of entities etc. For example, a company considering franchising may wish to form a new entity to offer franchises and must decide what type of entity to form, how to organize it, and what organizational documents are necessary. Due to the fact that franchisees buying into a system will want the unrestricted right to use the name and mark used by the system, a franchise lawyer will work with the franchisor to obtain registration of the trademarks. *Section 4(d)* and *(e) NOTAP Act* grants NOTAP the power to register franchise agreements involving foreign franchisors. The section goes further to state that the agreement shall be registrable if in the opinion of NOTAP, it involves the use of trademarks, the right to use patented inventions, the supply of technical expertise in the form of the preparation of plans, diagrams, operating manuals or any other form of technical assistance of any description whatsoever, the provision of operating staff or managerial assistance and the training of personnel etc.

By virtue of *Section 7 NOTAP Act*:

> *‘… no payment shall be made in Nigeria to the credit of any person outside Nigeria by or on authority of the Federal Ministry of Finance, the Central Bank of Nigeria or any licensed bank in Nigeria in respect of any payments due under a contract or agreement mentioned in section 4(d) of this Act, unless a certificate of registration issued under this Act is presented by the party or parties concerned together with a copy of the contract or agreement certified by the National Office in that behalf.’*

Regulation 4 of the Income Tax (Transfer Pricing) Regulations 1, 2012, states that where a connected taxable person has entered into a transaction or a series of transactions to which the Regulation applies, the person shall ensure that the taxable profits resulting from such controlled transactions are in a manner consistent with the arm's length principle otherwise the FIRS shall make necessary adjustments. Arm's length principle simply means that the conditions of a controlled transaction should not differ from the conditions that would have applied between independent persons in comparable transactions carried out under comparable circumstances.

The arm's length principle is relatable to franchising in that it seeks to guide the relationship between connected parties (companies that share common control or participate directly or indirectly in the management, control or profit of one another). For example, agreements between Group and Holding companies, subsidiaries, companies with the same directors etc. However, this provision would arise in the event of future collaborations/transactions (JVs, Technical Services Agreement etc.) between the franchisor and the franchisee as a means of preventing unfair advantage in the dealings of related entities. There are other provisions of the NOTAP Act which deals with franchising such as *section 6* providing for the basic requirements which must be included in the service agreement (including FAs) for it to be approved by NOTAP.

The basic problem with NOTAP regulating FAs between local and foreign entities is its lack of transactional focus. Some of the provisions in the NOTAP Act are too bureaucratic in nature without paying particular demands to the tenets and dynamics of the franchise Industry. Unfortunately, the same lack of transactional mindset is exhibited by many Nigerian regulatory agencies, whose consequent poor performance weighs businesses down, and negatively impacts competitiveness of Nigerian businesses.

International Perspectives

Other jurisdictions have already begun to enact and amend their laws in order to maximise the advantage of franchising. In the United States, some provisions of the *California Franchise Relations Act (CFRA)* were revised through the California Bill AB-525 which was passed into law in 2015. This sweeping new law gives franchisees across California more protections when purchasing, transferring and terminating their FAs. Sponsored by the Coalition of Franchisee Associations (CFA), the law affects new franchisees (i.e., those who are granted or renew an agreement after January 1, 2016) and current franchisees upon sale, transfer or termination of their FA. Specifically, the law amends the CFRA to

generally make FAs, more franchise friendly. The changes made were more significant in the sale, transfer and termination of FAs. For instance, the law changed the 30 day notice and cure period required before a franchisor can terminate an FA to a 60 day notice and cure period.

The franchise industry within the United States is showing no signs of slowing down. Franchising and distribution continue to make up a large part of the United States' economy. According to *The Franchise Times of 2014*, the top 200 franchise systems on its rankings had total annual sales in 2013 of $590 billion.

In South Africa (like Nigeria), there is also no singular law regulating franchising. However, franchising is adequately provided for in South Africa's *Consumer Protection Act 2008,* which defines franchising and its various concepts. It also covers provisions on certain consumer rights which afford protection to potential franchisees, chief among which are: (a) the right to obtain a disclosure document when assessing a franchise opportunity fourteen days before signing the franchise agreement. The disclosure document should contain the number of franchise outlets, list of current franchisees, franchisor's turnover and net profits etc.; (b) the right to cancel the agreement with no penalty within 10 business days of signing it (cooling off period); and (c) Protection against unfair discrimination by suppliers; and (d) protection against a franchisor receiving a direct or indirect benefit or compensation from suppliers to its franchisees or its franchise system unless the fact thereof is disclosed in writing with an explanation of how it will be applied.

Conclusion

In order for Nigeria to fully leverage franchising as a tool for economic development, it would be necessary to enact laws to guide franchise transactions. Franchising, as a form of strategic alliance holds a lot of promise for economic development by building up entrepreneurial capacity of local business people, indigenising the economy, and contributing to halt capital flight; hence, it should receive institutional support.

FAs are more often than not, one-sided in favour of the franchisor and as such, most franchisees would require protection through specific laws. General contract law cannot fully embrace the challenges therein. An example can be drawn from the landlord-tenant relationship. Before the passing of the *Tenancy Law of Lagos State 2011*, it was the norm for landlords to collect multiple years rent in advance. *Section 4 of the Law* put a stop to this "oppressive" act (although it is yet to be seen whether compliance has been as a result of the positive impact of *the Law* or due to the commercial realities of a depressed real estate market).

Nigeria should take a leaf in franchise regulation from United States and South Africa. The Disclosure Document and 'cooling off' period that are required in South Africa are additional points aiding the cause for franchise regulation in Nigeria. This would be particularly important where the franchisor is a foreign company; the franchisee needs to be adequately protected in a fair and balanced FA. Proper franchise regulation would go a long way in unleashing the entrepreneurial energy of Nigerians and also in creating an atmosphere which while inviting investment is also conducive for growth.