

Franchises: Territories and Restrictive Covenants

A substantial proportion of the value of a franchise consists of the methods, know-how, goodwill and trade secrets of the franchisor's business. This information is divulged to franchisees through the operating manual, during training and in the every day running of the franchise business. Without such disclosure, it would be almost impossible for franchisee businesses to operate successfully.

However, it is also important to ensure that your franchisees understand the value of the information that you have disclosed to them, and that they must use discretion in using it and not divulge it to third parties. A typical franchise agreement will operate for a period of five years, after which it may be renewed or sold, either to another approved franchisee or back to the franchisor.

Protecting Your Business

If a franchisee leaves the franchise how can you ensure that your competitors do not benefit from the information that you have entrusted to them? The answer is to ensure that your franchise agreement has sufficient provision for this eventuality. A substantial number of franchises operate on a territorial basis, which prevents another franchisee from conducting business in the same area. Others have postcode or other geographical limitations on advertising and/or soliciting new business.

It is not unusual to restrict a former franchisee from operating in the same area in which they carried on your franchised business. However, this cannot be too limiting and must not amount to a restraint of trade. For example, if you operate an estate agency franchise, you cannot prevent a former franchisee from being an estate agent but you can require them not to carry on their business within – and to a certain extent around - the territory in which they operated the franchise.

There is a fine line between protecting your business and imposing unreasonable restrictions on former franchisees. If a clause is too narrowly drafted the court may rule that it is unfair, leaving you with no protection at all. These clauses, known as restrictive covenants, must be drafted with extreme care so as to be reasonable. Whether or not a clause is deemed to be reasonable depends on factors such as the nature of the business, the territory and how much confidential information has been divulged to the franchisee.

To discuss how we can help you franchise your business successfully, contact us today.

*For more information contact PCB Solicitors on 01743 248148
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