Consumer and Competition Policy Directorate
Department for Business, Energy, and Industrial Strategy
4th Floor
1 Victoria Street
London
SW1H 0ET

SENT VIA EMAIL TO: competition@beis.gov.uk

15 March 2022

Dear Sirs,

We are responding to you in relation to the draft Competition Act 1998 (Vertical Agreements Block Exemption) Order 2022 that you have recently published. Set up over 40 years ago, the British Franchise Association (bfa) represents 310 franchisors. It is committed to ethical franchising and is a member of the European Franchise Federation (EFF) which has produced a Code of Ethics. All bfa members are required to comply with the EFF's Code of Ethics.

Franchising is an integral part of the UK economy. With 48,600 franchise units, employing more than 710,000 people, the industry now contributes more than £17.2 billion per annum to UK GDP.

The bfa was invited to participate in the round tables organised by the Competition and Markets Authority at the beginning of the review process and actively contributed to issues relating to the proposed new UK block exemption. The bfa welcomes, as set out in paragraph 2.2 of your explanatory memorandum to the draft Order, the purpose of the Order "to ensure that businesses are not prevented or disincentivised from entering into agreements that the [CMA] considers to be overall beneficial and not anti-competitive." In particular, the bfa approves the new approach adopted in the draft Order in relation to internet sales so as to ensure a level playing field between internet sales and bricks and mortar sale as well as the CMA's decision not to impose additional market share requirements in relation to information exchange in dual distribution arrangements.

However, the bfa believes that the draft Order fails to address a number of areas and, as a result, retains continued uncertainty which substantially reduces the likely positive effect of the Order when enacted. These uncertainties are:-

- Definition of "know-how" – The definition of know-how in section 3(7) of the draft Order reflects the definition in the EU's block exemption. The relevance of know-how is limited to enabling suppliers (or in the case of franchising, franchisors) to impose post termination non compete covenants which are "indispensable to protect know-how transferred to a buyer (in the case of franchising, a franchisee) and is also relevant to confidentiality obligations.

  The problem with the definition of know-how at both the EU and the UK level is that it is subjective as to whether franchisor's know-how (usually contained in the franchisor's operations manual) is secret, substantial and identified. In particular what is secret or substantial is difficult to establish and with great respect to judges they are generally unable to make an informed assessment. As a result, the requirements of what constitutes "know-how" simply adds a level of uncertainty for no obvious benefit. Retaining this definition facilitates arguments between franchisors and franchisees as to whether the franchisor's know how is secret and substantial – identified, since it is usually contained in a separate operations manual, is less troublesome.

- Post term non compete covenants – The imposition of short and reasonable post termination non compete covenants are an essential feature of franchising because no franchisor would be prepared to pass on its know-how without protection from competition. Often, in a franchise relationship, franchisees who have benefited from the franchisor's brand to build up their business and the know-how and training provided by the franchisor may, after a period of time, believe that they have received all the benefits they can from the franchisor and, as a result, may question the benefit of continuing to pay service fees to the franchisor, believing instead that operating independently may be to their financial advantage. Accordingly, the enforceability of post termination non compete covenants is vital to the continued success of franchising. Unfortunately, based on the franchise market in Europe (but not in the UK), the EU's block exemption allows a post term non compete obligation to be imposed if it is limited to the "premises and land from which the buyer has operated during the contract period". [Article 5.3(b)] The draft Order reflects that wording in section 10.4(a)(ii). The Court of Justice in the case of Retoucherie Manuela SL confirmed that those words relate only to places where the contract goods are offered for sale and not to a franchisee's territory. In other words, it applies to a retail outlet. In the UK a very substantial number of franchises are service based and are provided by franchisees offering those services from vehicles. On

the face of it, it appears that post termination non compete covenants may not be imposed on those franchisees. There is no reason for this distinction.

- In term non compete – Section 10.2 of the draft Order lists, as an excluded restriction, a non compete obligation lasting more than five years. There are exceptions. A non compete obligation is defined in section 10(5) and has two elements to it. The first is what is generally understood to be an in term non compete covenant and the second is a prohibition on a buyer (franchisee) being required to purchase from a supplier (franchisor) or from its nominated supplier more than 80% of the franchisee's requirements for goods or services. The five year period is wholly arbitrary. Whilst a majority of franchise agreements in the UK are granted for five years, some are granted for longer, particularly those which involve substantial upfront investment by a franchisee who, as a result, requires a longer term in which to amortise that investment. The five year approach contained in clause 10.2(a) creates quite unnecessary challenges for those franchises. Further, it is unclear whether in a seven or ten year franchise agreement franchisors must specify that the non compete obligations only applies for five years and if they do not, whether such obligations are unenforceable ab initio.

  Finally, section 10.2(a) is illogical. If franchisors are able to impose post term non compete covenants when granting a seven year franchise term why between years 5 and 7 would a franchisee be allowed to be involved in a competing business when prevented from doing so on termination?

We should be most grateful if the issues identified in this letter could be reviewed.

Yours faithfully

Chief Executive

British Franchise Association