

Hamilton Pratt Article

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FRANCHISE NON COMPETE CLAUSES



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All franchise agreements contain both in-term non compete clauses and post term non compete clauses. In-term restraints prevent franchisees and the principals who have established the franchise from competing during the term of the franchise agreement. Franchisees and their principals are generally also required to devote their whole time and attention to the franchised business unless they have obtained the franchisor's permission. Franchisors almost never give permission so as to allow involvement in a competing or similar business during the term of the franchise. Usually these in-term non compete covenants do not give rise to difficulty because they are so obviously in the best interest of the franchise network.

The same cannot be said of post termination non compete covenants – these apply after the franchise agreement comes to an end. The English courts have made their position clear in relation to post termination non compete covenants in franchise agreements. Unlike similar covenants in employment contracts they are generally enforceable provided they are reasonable. A one year post termination non compete covenant in the territory which had been franchised will normally be held to be enforceable although, generally, any restraints outside a franchisee's territory will not be upheld.

An added level of complexity is created because of competition law considerations. These considerations are complex but, in essence, franchise agreements are regulated by section 2 of the Competition Act 1998. The Act indicates that franchise agreements will be exempted from the application of competition laws if they fall within an EU block exemption. Generally, UK franchise agreements are drafted so as to comply with the EU's vertical agreements block exemption, article 5 of which entitles the franchisor to impose post termination non compete covenants although article 5 only permits such covenants to be enforced to prevent an ex franchisee from being involved in a competing business from the franchisee's premises and not more widely. On the face of it, therefore, a territory wide restriction would be too wide, but the Court of Justice, which is the most senior court in Europe, has made it clear, in the Pronuptia case, that franchisors are entitled to protect their know how by enforcing non compete covenants and such non compete covenants can be wider than applying simply to the franchisee's franchised premises.

In the English court's decision in Pirtek, the court relied on the Pronuptia case to enable it to enforce a non compete covenant within a franchisee's territory and not simply at the franchisee's premises. It is likely that English courts will make use of the Pronuptia decision to enforce territory wide non compete covenants unless a franchisee can persuade a court that the franchisor simply does not have any "know how" to protect which would not be an easy thing to do.

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