

Pakistan

Key elements of franchising from an IP perspective

A full understanding of the concept of franchising may be established by considering the different definitions of the concept adopted by various authorities and organisations.

The British Franchise Association defines 'franchising' as a contractual licence granted by one person (the franchisor) to another (the franchisee) which:

- permits or requires the franchisee to carry on, during the period of the franchise, a particular business under or using a specific name belonging to or associated with the franchisor;
- entitles the franchisor to exercise continuing control, during the period of the franchise, over the manner in which the franchisee carries on the business which is the subject of the franchise;
- obliges the franchisor to provide the franchisee with assistance in carrying on the business which is the subject of the franchise (in relation to the organisation of the franchisee's business, the training of staff, merchandising, management or otherwise);
- requires the franchisee periodically, during the period of the franchise, to pay the franchisor sums of money in consideration for the franchise, or for goods or services provided by the franchisor to the franchisee; and
- is not a transaction between a holding company and its subsidiary (as defined in Section 736 of the Companies Act 1985) or between subsidiaries of the same holding company or between an individual and a company controlled by him or her.

The International Franchise Association defines it as follows: "A franchise operation is a contractual relationship between the franchisor and franchisee in which the franchisor offers or is obliged to maintain a continuing interest in the business of the franchisee in such areas as know-how and training; wherein the franchisee operates under a common trade name, format and/or procedure

owned or controlled by the franchisor, and in which the franchisee has or will make a substantial capital investment in his business from his own resources."

In *Bolan Beverages v Pepsico* (2004 CLD 1530, p 1539) the Pakistan Supreme Court referred to the definition of 'franchising' given in *Black's Law Dictionary* in the following terms: "As franchise is not defined in our own Contract Act, we may have a reference to *Black's Law Dictionary* 6th Edition page 658, where franchise is defined as 'a privilege granted or sold, such as to use a name or to sell products or service. The right given by a manufacturer or supplier to a retailer to use his product and name on terms and conditions mutually agreed upon.' In its simplest terms, a franchise is a licence from the owner of a trademark or trade name permitting another to sell a product or to serve under that name or mark. Precisely this definition is more akin to a licence rather than an agency. What exists between the present parties is more suitable to be determined in the light of the agreement itself than the relevant laws on the subject."

Perhaps the only definition of 'franchising' occurring in Pakistani legislation is included in the Federal Excise Rules 2005, which were introduced under the Federal Excise Act 2005: "'Franchise' means an agreement by which the franchisee is granted representational rights to sell or manufacture goods or to provide service or to undertake any process identified with franchisor against an agreed fee or consideration including royalty, whether or not a trademark, service mark, trade name or logo or any such symbol, as the case may be."

It also includes the following definition of a 'franchisor': "'Franchisor' means any person who enters into franchise and includes any associate of franchisor to enter into franchise on his behalf, and the term 'franchisee' shall be construed accordingly."

There is thus no uniformity in the descriptions of what exactly a franchise is and the extent of the franchise agreement.

Nonetheless, some common features do emerge from the different definitions, such as:

- a contractual relationship flowing from franchisor to franchisee;
- the franchisor's control over all business operations of the franchisee;
- the franchisor's provision of assistance to the franchisee in setting up, developing, operating and promoting the business; and
- the franchisee's payment of a royalty and fee to the franchisor.
- acknowledgement of the franchisor's IP rights by the franchisee;
- a licence granted by the franchisor allowing the franchisee to use the IP rights;
- consideration for the contract, royalty or fee;
- control by the franchisor over the franchisee's conduct of its business and use of the IP rights;
- adherence by the franchisee to the franchisor's methods, specifications, business methods and modes and channels of sale of products or provision of services;
- a commitment to uniformity in the goods sold or services provided; and
- the establishment of consumer relationships with the franchisor via the franchisee, and limitations imposed thereon by contractual warranties, indemnities and guarantees.

Importantly, the franchisor and franchisee are two distinct legal entities with their own profit and loss liabilities.

Evolution of franchising in Pakistan

Franchising is not a new concept in Pakistan. This commercial model has been in existence ever since Pakistan's independence, although it took a different form.

The earliest franchise operations in Pakistan were conducted by petrol stations such as Pakistan Burmah Shell and CALTEX. The popular beverage brands of 7-UP, Coca-Cola and Pepsi Cola were also among the earliest franchise operations in Pakistan, in a slightly different context. Here, the term 'franchising' was applied to these agreements insofar as concentrate for the soft drinks was supplied by the franchisor to the franchisee/bottler in Pakistan. The agreement was usually entitled "Franchise and bottling agreement" – and to a certain extent this terminology still survives today.

In Pakistan today, franchise agreements are most commonly found in the fast-food and telecommunications industries, and as business operations modules in the services sector. Crucial to these agreements are IP and other rights such as trademarks, copyrights, trade dress (eg, interior and exterior décor), know-how, trade secrets, designs, patents and operating manuals.

In this regard, the franchising agreement usually includes the following provisions:

Contractual arrangements

In Pakistan, no specific law governs all issues relating to franchising. Therefore, the relationship between the parties and their respective rights and liabilities are principally governed by contractual arrangements that, by law, are subject to strict interpretation of the terms of the contract.

Therefore, the franchising relationship is purely contractual in nature. However, it is governed not only by the contract itself, but also by Pakistan's IP laws, insofar as the use of the IP rights is concerned.

In a broader sense, other laws also recognise the concept of franchise arrangements, such as foreign exchange laws (eg, in relation to the remittance of royalties and franchise fees).

Myths and realities

There is a dramatic conceptual collision when it comes to the question of whether the franchisee is an agent of the franchisor.

Franchisors maintain that the franchise is merely a form of licensing or an agency not coupled with interest and is therefore revocable, whereas franchisees dispute this and, on the contrary, maintain that the franchise

Licensing	Franchising
• Trademark/service mark use only • Licensing of goods may not involve purchase of raw material from the licensor • Licensor has limited rights and controls	• Use of whole concept, including trademark/service mark • Franchising involving goods invariably requires purchase of raw materials and goods from franchisor or approved suppliers • Franchisor has more substantial rights and controls

agreement cannot be terminated without compensation as it is an agency coupled with interest.

In Pakistan, the issue of termination of a licence agreement was clarified in the *Bolan Beverages Case* (2004 CLD 1530) and the *Sensodyne Case* (2005 CLD 1805), in which the courts rejected the argument that a licence is an agency coupled with interest and held that such an agency was neither irrevocable nor coupled with interest; rather, it was a simple licence and was revocable.

The franchise agreement may be distinguished from a pure licence, agency, distributorship, dealership or retailing agreement. The key differences between licensing and franchising are outlined in the table on the previous page.

Relationships

Franchisor-franchisee

Under Pakistani law, the franchisor-franchisee relationship is governed by the terms of the franchising agreement.

Under ordinary circumstances, the franchising agreement takes the form of a licence insofar as the use of IP rights is concerned and no agency rights are created.

Each party remains responsible and liable for the performance of its own obligations. The franchisee's obligations and liabilities do not flow through to the franchisor.

Customers

Franchising agreements typically include a clause specifying that any product liability issues are the franchisee's responsibility, and that under normal circumstances such liability cannot be passed onto the franchisor.

If product liability issues arise as a result of acts or omissions on the part of the franchisor, the franchisee may still find itself unable to pass liability onto the

franchisor, although it may have a remedy of damages against the franchisor on the basis of such acts or omissions.

Termination, enforcement and conflicts of law

In general, either party can terminate the franchising arrangement in the manner specified in the agreement.

Pakistani law envisages a single exception to this general rule: where the franchisee can establish an interest in the subject matter of the franchise, the franchise cannot be terminated unilaterally.

If the franchisor is a foreign company governed by foreign law, the Pakistani courts will recognise:

- the parties' right to choose any foreign law as the law governing the franchise agreement;
- the parties' right to opt for arbitration in a foreign country, which may be governed by any set of rules, law or forum through mutual agreement; and
- the enforceability of a foreign arbitration award in Pakistan.

However, any agreement in restraint of trade under Pakistani contract law is void (Section 27).

Usually, a franchise agreement includes a clause prohibiting the franchisee from engaging in any business in competition with the franchisor for the duration of the franchising agreement and for a certain period post-termination.

Generally such contractual covenants may be invalid in Pakistan; however, there may be certain situations in which the court may enforce such a covenant, particularly during the continuance of the agreement or for a specific limited period of time after the termination of agreement where it can be demonstrated to the court that special or peculiar circumstances exist for so doing.

Hasan Irfan Khan's primary areas of practice include trademarks, copyright, patents and unfair competition/passing-off law. He has vast experience in anti-counterfeiting and enforcement litigation and has conducted various landmark IP cases before the Pakistan high courts. He is also admitted to practice before the Supreme Court of Pakistan. Mr Khan lectures in IP law at various institutions and has sat on government committees to make and enforce changes to IP legislation. He was recently nominated as one of the world's Leading Trademark Law Practitioners by Managing Intellectual Property magazine.

Hasan Irfan Khan

Partner

Tel +92 42 628 5581 4

Email Hasan.Khan@UnitedTm.com

United Trademark & Patent Services**Pakistan**

Pakistan



Maria F Khan is a law graduate of Wolfson College, University of Cambridge, and also holds a BSc in major biological chemistry from Wellesley College, Boston. She specialises in patent prosecution and also deals with trademarks, copyrights and industrial designs. She has also assisted senior partners of the firm in contentious patent and trademark matters. At present Ms Khan is on sabbatical to pursue the UK Bar Vocational Course, where she has received the Lincoln's Inn Hardwicke award.

Maria F Khan

Associate

Tel +92 42 628 5581 4

Email Maria.Khan@UnitedTm.com

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