

THE PROBLEM WITH ONLINE DIRECTORIES

Increasing use of on line directories by those seeking to buy services is undermining the efforts of franchisors to operate territory based franchise models for non-premises based franchisees.

Once upon a time customers looked for service providers in Yellow Pages and many franchisors still use Yellow Pages coverage areas as territory boundaries. It did not matter where the franchisee was based, as potential customers in his territory would find his contact details in their local Yellow Pages. It did not matter if he operated from a base in another franchisee's territory as customers in that territory would not find him in their Yellow Pages or Thompson Local.

Until recently the use by consumers of Yellow Pages or an on-line search for a service provider's website allowed franchisors to direct enquiries to the correct franchisee for the relevant territory. Now however, on-line directories such as Yell.com or Google Places direct searchers to the franchisee whose address is within the prospective customer's geographical area of search irrespective of the franchisee's allotted territory.

Changes in technology and buyer behaviour have thus overtaken franchisors' contracts and operations manuals based solutions to the legal prohibition on enforcing strict territorial boundaries.

That prohibition stems from competition law disapproval of "export" bans and the suppression of price competition between businesses in different territories. It means that any absolute contractual prohibition on a franchisee from providing services outside his territory is potentially void, could make the entire agreement void, and the franchisor liable to fines.

The law does however recognise that franchisees and distributors are entitled to some territorial protection (it works both ways, your freedom to sell in my territory takes unfair advantage of my investment in marketing) and permits contractual restrictions on "active" out of territory selling. This means that the franchisee can be prevented from trying to sell outside his territory but not from selling to out of territory customers who seek him out—so called "passive" sales.

Historically, really cute franchisors have insisted on their franchisees only advertising a central telephone number in their advertisements so all calls came to franchise HQ and could be diverted to the appropriate territory franchisee.

Then along came the internet and enterprising franchisees could set up their own websites. Websites, even if they contain the franchisee's out of territory address are regarded as passive selling so franchisors could not prohibit them. Suddenly customers using the internet could find and contact the franchisee nearest to them, irrespective of his territorial rights.

Franchisors responded by requiring franchisees to have pages (their own website) on the franchisor's central website which did not include their out of territory address and sometimes, also, to only using a central telephone number. Although strictly franchisors should not prevent franchisees having their own websites as well, in practice, if the dedicated central page did the trick, franchisees were unlikely to set up their own websites.

The latest developments however, mean that potential customers no longer need to go to the franchisor's website. Instead they go to an on-line directory and enter the search terms "plumber" in "winchester." If the Southampton (ten miles from Winchester) territory franchisee happens to live and have his base in Winchester and subscribes to a land line (and you cannot have broadband or use a non-geographical number without one) that land line will have a geographical telephone number. Unless is it ex-directory that number and the name of the subscriber (Superfast Plumbing (Southampton) Limited) will be picked up by the directories and provided to anyone seeking "plumber in winchester".

The franchisee responding to the resulting call and providing services in Winchester will be passive selling. The franchisor may be in breach of competition law if it prohibits it.

There are of course possible solutions. The franchisee could be required to use an ex-directory number, subscribe in his private name, or only use a mobile phone but all of these would mean his business would not appear on the on-line directories at all.

Alternatively all calls to his landline could be diverted to the franchisor's central number for re-direction, or the franchisee could be required to pass all such calls, to the appropriate territory franchisee or just prohibited from passive selling. He could be required to maintain an accommodation address within his territory and subscribe for his landline from there.

These solutions have various disadvantages—loss of free advertising, additional cost, and the franchisee's unwillingness to turn away business. Furthermore all require provisions in the franchise agreement or operations manual if the franchisor is to enforce them which are likely to contravene the legal prohibition on anti-competitive practices because they are intended to prevent passive selling. A better approach might be for the franchisor to positively assist the franchise to maximise sales within his own territory using the "new technologies" part of which could be setting up a scheme which discourages (but does not prohibit) out of territory sales. There are consultancies out there with the necessary expertise and some with specific franchising experience.

The anti-competitive behaviour prohibition is of agreements and concerted practices likely to restrict or distort competition in part of the UK or EU. As mentioned above export bans (and this

would include bans on exports of goods or services across the boundary between two franchisees' territories) are regarded as likely to restrict or distort competition. On the face of it therefore doing anything to restrict passive selling by one franchisee into the territory of another is contrary to that prohibition even if not legally enforceable.

There is however one saving grace. The law acknowledges that because the prohibition is so wide (two ice-cream vendors agreeing to operate at different ends of the park could be caught) that agreements and practices are only prohibited if they cause "an appreciable effect on competition" in the relevant area.

Most franchisees operate in intensely competitive markets (the example, of plumbing, being a case in point) and are in any event micro-businesses which, however hard they try, are unlikely to create "an appreciable effect" or to attract the attention of the competition authorities.

It is of course possible that a disgruntled franchisee could argue in court that his agreement was void for breach of the prohibition but such claims have not, on the whole, been successful in the past and in any event are expensive to run which may discourage such claims.

There is also the remote possibility that a third party could bring a claim against the franchisor alleging that he paid more for his plumbing than he would have done had full competition been permitted between the different franchisees. That is very remote indeed.

If therefore the average franchisor (this excludes large international concerns with substantial market shares) is being troubled by cross territory competition between its franchisees caused by the use of on-line directories it can be reasonably confident that sensible use of technological, contractual and operating manual provisions to prevent it is unlikely to cause legal problems.

Geoffrey Sturgess 2012

E: geoffreysturgess@warnergoodman.co.uk

T: 02380 717424