

Trade Marks and Franchising in Kenya

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of the Bachelor of Laws degree**

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Declaration

I Joan M. Chesoni declare that this is my original work and that it has not been submitted in any other University.

Signed.....*J. Chesoni*.....
Joan Chesoni

This dissertation has been submitted with my approval as a University of Nairobi supervisor.

Signed.....*Dr Ben Sihanya*.....
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INTERVIEWS CONDUCTED

Bernard Sihanya, (Dr.) Intellectual Property & Innovation Lecturer, University of Nairobi, School of Law, interview on 3/10/07 at University of Nairobi, School of Law, Nairobi.

Gavin Bell, (Mr.) Chairman Kenya Franchise Association, interview on 12/05/06 at Kengeles Lavington. Nairobi.

Henry Clark, (Mr.) C.E.O Hoggers Limited Kenya, interview on 3/07/07 at Steers Muindi Mbingu, Nairobi.

Lorraine Ogombe (Ms.) Head of Intellectual Property Programme concerning research in copyright, trade mark, merchandising, trade secrets and patents at Innovative Lawyering, interview in late 2006 at University of Nairobi, School of Law, Nairobi.

Nurdin Ajania, (Mr.) Steers Regional Franchisee, Hoggers Limited Kenya, interview on 3/07/07 at Steers Muindi Mbingu, Nairobi.

TRADE MARKS AND FRANCHISING IN KENYA

RESEARCH PROPOSAL AND METHODOLOGY

1. The Research Questions

This paper was an attempt to investigate the operation of trade mark law in facilitating the establishment of franchises in Kenya. I sought to answer the following questions:

1. To what extent do trade mark laws in Kenya protect the interests of the franchisors and franchisees?
2. Do trade mark laws in Kenya facilitate transfer of technology through franchises of foreign origin?

2. Argument

I argued that the trade mark law in Kenya is inefficient due to the weak legal framework in place. I also argued that the institutional framework in relation to trade mark law is inadequate. Further, I argued that as a result, trade mark law does not encourage the franchising business system in Kenya.

3. Statement of the Problem or Background

Trade marks are everywhere. They surround us in the various daily transactions we undertake pertaining to purchase and sale of goods and services. Trade marks are legally protected names, words, symbols or designs (or a combination) that the owners or sellers of products use in order to distinguish their products from others. According to Dr Ben Sihanya trade marks are regarded as the second level of innovation, which consists of “going into the market.” Trade names, which are different from trade marks, are names registered by companies or businesses for the purpose

of identification. One may register a trade name (if they have used it for a while) as a trade mark.¹

Sihanya further states that trade marks seek to answer the question “what is in a name, mark, sign, signature, symbol, sound, shape or smell?”² It can be therefore be said that trade marks aid the potential consumer in identifying specific products and differentiating them from others. In time, the consumer begins to attach a particular value or standard with the specific product. The consumer identifies the trade mark of the product with that value he has attached to that product. An example is the Steers fast food chain’s slogan “Real Food Made Real Good,” most Kenyan fast food consumers automatically associate the name Steers (which is also a trade mark) with good quality food. This goes towards building the “name” of that product in the market, as more and more consumers begin to identify the product with its trade mark. Another example is the trade mark Coca Cola. This is mentioned in many places worldwide, and the name Coca Cola is immediately identified with the soft drink Coca Cola.

Trade marks also ensure that consumers are not confused into buying products of inferior quality. Through this function, customers are satisfied that they are getting best value for their money in relation to a particular trade marked product. Owners of trade marks require guarantees as to the exclusive right to use their particular trade marks to identify their products, especially when launching their already established products in new markets. Trade mark owners carefully scrutinize the protection afforded by the legal system of a particular territory before making the

¹ Bernard Sihanya (2005) *Intellectual Property Law- Lecture 11 to LLB IV MODULE II on 22/06/05*, University of Nairobi, School of Law. Bernard Sihanya is a Teacher and Attorney of Intellectual Property and Innovation, Education Law as well as Constitutional Political Economy and ICT Law at the University of Nairobi.

² B. Sihanya *Intellectual Property Law- Lecture 11. op.cit.*

decision to launch their product in that territory. The reason behind this action is that trade marks form an essential part of business goodwill. Goodwill was aptly defined by Lord Macnaghten in *The Commissioners of Inland Revenue v. Muller & Co's Magarine Ltd*³ as follows:

“What is goodwill? It is a thing very easy to describe, very difficult to define. It is the benefit and advantage of a good name, reputation, and a connection of the business. It is the attractive force that begins in custom. It is the one thing which distinguishes an old established business from a new business at its first start. The goodwill of a business must emanate from a particular centre or source. However widely extended or diffused its influence may be, goodwill is worth nothing unless it has the power of attraction sufficient to bring customers home to the source from which it emanates.”

Goodwill has also been defined as the advantage arising from the reputation and trade connections of business, in particular the likelihood that existing customers will continue to patronize it.⁴ From the two definitions, it can be seen that the identity of the goodwill owner is irrelevant; what matters is that the consumers are assured of a certain standard in relation to the product. The reputation of a product speaks for it. For goodwill to exist, the product must have a good reputation.

In the area of franchising, the owner passes on ownership of trade marks to a second party by way of a licence and in accordance with a franchise agreement between the two parties. Franchising is a fast and rapid moving business system in the world. According to a survey in the United Kingdom by National Westminster Bank and British Franchise Association (BFA), by the year 2000 there were 665 active franchise systems with a projected increase of 4% year - on - year.⁵ It is a fast and efficient way for trade mark owners to expand the market for their products while enabling the franchisees to establish a successful business without having to go through the process of establishing goodwill for a product in the market.

³ [1901] AC 217, at p. 223.

⁴ E.A. Martin(ed) *A Dictionary of Law*, OUP, New York, (5thedn), p.221.

⁵ British Franchise Association, National Westminster Bank (2004) *BFA/Natwest Franchise Survey*, United Kingdom.

In addition to granting a franchisee the licence to use the trade mark, the franchisor may also supply the franchisee with brand identity as well as finance and technical expertise. In return, the franchisee's input is in the form of a royalty on sales and local expertise.

Both the laws regulating the relationship between the franchisors and franchisees and the laws protecting their interests need to be sound to ensure a balanced relationship profitable for both parties. The degree of control a trade mark owner has over a franchisee is generally greater in comparison to other standard trade mark licensing agreements. It is therefore essential that intellectual property law and other related law⁶ of a given state be able to efficiently regulate the relationship between the franchisor and franchisee. The law should ensure that the interests of the franchisor in relation to his trade mark are well protected and that on the other hand, the franchisee is not exploited by the franchisor.

Franchising in Kenya is almost non-existent and is limited to Southern African brands such as clothes outlet Woolworths, food outlets Nandos and Steers and Supreme Furniture, all which have had global presence. KFC was present in the 1970s but closed shop due to problems associated with the local franchise. The Kenya public is highly sensitized to brand names. As such, local entrepreneurs can do well to emulate Egypt and South Africa in this sector....

Franchising in Egypt has become one of the most successful services of recent years. The existing 211 franchises have contributed approximately USD 4 billion to economic growth in form of direct investment over the past few years. The franchising industry employs 36,000

⁶ The laws relating to franchising are discussed in Chapter 2 §2.2.

people and generates USD 1 billion annually. In addition, a range of feeding industries has developed to service the sector.⁷

Kenya, like many developing countries, is always seeking to improve her economy, especially in the area of technological advancements. The franchising business system appears to present a possible avenue through which transfer of technology can occur especially if the franchise is of foreign origin. The question that arises in the Kenyan context is whether the existing legal and institutional frameworks sufficiently encourage franchising. If these systems are lacking, how can they be improved?

4. Objectives

In this dissertation, the specific objectives are to:

1. Investigate whether the current trade mark laws in Kenya have hindered the development of franchises in Kenya.
2. Investigate the link between franchising and the transfer of technology, and whether franchising can be a conduit, through which a country such as Kenya can acquire much needed technology.

My general objective is to add to the literature in this area of trade marks and franchising from a Kenyan perspective.

⁷ This information is sourced from a Kenya Government official who wishes to remain anonymous. The official is affiliated to the Ministry of Foreign Affairs and is currently working in Nairobi. The information was provided in March 2006.

CHAPTER 1

TRADE MARK AS INTELLECTUAL PROPERTY

This Chapter discusses trade marks as a form of Intellectual Property. It begins with a brief explanation of what Intellectual Property is. The laws governing Intellectual Property and its attendant rights are also discussed. Trade marks are often the backbone of most franchising agreements. Dr. Sihanya defines franchising as the exploitation or use of an established brand, which may be in the form of copyright, patent or trade mark,¹³ but usually trade mark.¹⁴ The purpose of exploiting the established brand is usually to set up a business venture that is perceived to sure success due to the goodwill the established brand bears. In line with my argument that Kenya trade mark law is inefficient due to the weak legal framework in place, an examination of the legal regime governing trade marks in Kenya will be carried out. The exploration of the law is also necessary in order to test the hypothesis that Kenya trade mark law does not sufficiently support franchising business system therefore hindering transfer of technology in Kenya.

1.1. What is intellectual property

Intellectual property (IP) refers to creations of the mind: inventions, literary and artistic works, and symbols, names, images, and designs used in commerce.¹⁵ IP has also been defined as information that has economic value when put use in the marketplace. Jayashree Watal in her article "Implementing The TRIPs Agreement"¹⁶ states that IP can loosely be defined as creations of the human mind.

¹³ The various forms of Intellectual Property i.e. copyright, patents and trade marks are further discussed in this Chapter. See § 1.3.

¹⁴ Bernard Sihanya (Dr.) Teacher and Attorney of Intellectual Property and Innovation, Education Law as well as Constitutional Political Economy and ICT Law at the University of Nairobi. Interview on 3/10/07 at Innovative Lawyering offices, University of Nairobi, faculty of Law.

¹⁵ WIPO (2005) "About Intellectual Property" at <http://www.wipo.int>, accessed 19/08/2005.

¹⁶ Jayashree Watal (2002) "Implementing The TRIPs Agreement," *Development Trade and the WTO:- A Handbook*. The International Bank for Reconstruction and Development/ The World Bank (2002). p.359-368.

William Cornish and David Llewelyn in their book *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*,¹⁷ use the term IP to describe the various forms of intangible property that include trade mark, patent, copyright. David Bainbridge in his book *Intellectual Property* opines that IP is the sum of the different rights (or areas of law giving rise to these rights), associated with creative effort, commercial reputation and goodwill.¹⁸ Ben Sihanya states that IP is the protection, promotion or recognition of the work of the mind through rewards, incentives as well as legal mechanisms for the enforcement or vindication of these rights in the case of infringement.¹⁹ Thus it can be said that IP is a collection of the intangible creations of the human mind that have commercial value, and the attendant rights arising from these creations.

Intellectual property is divided into two broad categories: Industrial property and Copyright. Industrial property includes inventions (patent), trade mark, industrial design, and geographic indication of source. Copyright includes literary, artistic and musical works. Examples are novels, poems and plays, films, musical works. Specifically, artistic works include drawings, paintings, photographs and sculptures, and architectural designs. Rights related to copyright include those of performing artists in their performances, producers of phonograms in their recordings, and those of broadcasters in their radio and television programmes.²⁰ Rights arising from intellectual property are known as intellectual property rights (IPR). The

¹⁷ William Cornish and David Llewelyn (2003) *Intellectual Property*, Sweet & Maxwell London (5th Edn). William Cornish is Herchel Smith Professor of Intellectual Property Law, University of Cambridge UK, and David Llewelyn is the Head of Intellectual Property, White& Case (London), and a Visiting Professorial Fellow, Queen Mary College, University of London.

¹⁸ David Bainbridge (1999) *Intellectual Property*, Financial Times, London (4th Edn). Dr. David Bainbridge is a Barrister, Reader in Law, Aston Business School, Aston University, UK.

¹⁹ Bernard Sihanya (2006) *Intellectual Property Law teaching materials II Lecture to LLB IV MODULE II on 13/02/06*, University of Nairobi, Faculty of Law. I was a student in this class and the abovementioned teaching materials used are on file at Innovative Lawyering Nairobi.

²⁰ WIPO (2005) "About Intellectual Property." *op. cit.*

Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPs) defines IPR as rights given to persons over the creations of their minds.²¹

1.2. Intellectual property law

Intellectual Property Law is the law giving IPR a legal dimension. David Bainbridge in his book *Intellectual Property*²² defines intellectual property law as that area of law, which concerns legal rights associated with creative effort or commercial reputation and goodwill.

The legal regime of IP is governed by TRIPs, which is a constituent of the agreement establishing the WTO. According to Fatoumata Jawara and Aileen Kwa in their book *Behind the scenes at the WTO: the real world of international trade negotiations lessons of Cancun – updated edition*²³ the main function of the WTO, like the General Agreement on Tariffs and Trade (GATT) before it is to ensure that member governments keep their trade policies within agreed limits. Its members sign agreements to this effect every so often, following a long process of negotiation. Once signed, the agreements provide the legal ground rules for international trade within a multilateral framework - they are essentially binding contracts to which governments are expected to adhere. There are however special considerations for implementation in developing countries. Developing countries have a longer period to domesticate the TRIPs agreement.

The TRIPs agreement entered into force on January 1, 1995, concurrently with the rest of the WTO agreement. According to Bernard Hoekman in his article “The WTO: Functions and

²¹ WTO (2005) “WTO Legal Texts” at <http://www.wto.org>, accessed 19/08/2005.

²² David Bainbridge, *Intellectual Property. op. cit.*

²³ Fatoumata Jawara and Aileen Kwa (2004) *Behind the scenes at the WTO: the real world of international trade negotiations lessons of Cancun – updated edition*, Zed Books Ltd, Fatoumata Jawara is a freelance international trade and development analyst, and Aileen Kwa is a trade analyst, Focus on Global South.

Basic Principles”²⁴ WTO rules apply to all members, who are subject to binding dispute settlement procedures. This means that WTO rules are essentially legally binding to all WTO member states once they have completed implementation.

The TRIPs agreement covers all the major IPR including some new areas not previously addressed by international law, or in some cases, even by national laws of many industrial countries. On the international level, member states that breach the TRIPs agreement may face legal action at the WTO’s Dispute Settlement Body. On a national level, the implementation of TRIPs requires domestication of the agreement into national legislature.

The provisions of the TRIPs agreement can be broadly divided into five categories. The first category is standards; the TRIPs agreement sets out the minimum standards of protection to be accorded by WTO members in each of the main areas of IP. Previously, most of the existing international IP regimes which included the Berne Convention on Literary and Artistic Works 1896, the Paris Convention on Protection of Intellectual Property 1883, had nominal levels of protection. For the most part, the TRIPs agreement requires members of the WTO to recognize the existing standards of protection within the Berne and Paris Conventions as well as demanding substantive protection for other forms of IP.²⁵

An area where TRIPs has been precise in the establishment of minimum standards is Patents. In patents, TRIPs adopts the *Diamond v. Chakrabarty*²⁶ standard, which states that everything or anything under the sun made by man is patentable. Further, under Article 27(1) and (2) of

²⁴ Bernard Hoekman (2002) “The WTO: Functions And Basic Principles” *Development Trade and the WTO:- A Handbook*. The International Bank for Reconstruction and Development/ The World Bank (2002). p.41-49.

²⁵ See Lionel Bently and Brad Sherman (2004) *Intellectual Property Law*, Oxford University Press New York (2nd Edn). p. 7.

²⁶ 447 U.S. 303 (1980).

TRIPs, there should be no arbitrary exclusion of any invention from patentability.²⁷ Article 27(2) and (3) gives the categories of exclusions.

The second category of the provisions deals with domestic procedures and remedies for enforcement of intellectual property (IP). Under this provision, minimum procedures and remedies must be available and efficient so that rights holders can effectively enforce their private rights in a domestic context. Additionally, these procedures should be deterrent to further infringement.

The third category of provisions deals with dispute settlement. The TRIPs agreement puts disputes between WTO members with regards to compliance under the purview of the WTO's dispute settlement procedures.

The fourth categories of provisions are general provisions and principles. In this category, the basic principles of the WTO multilateral trading system such as non-discrimination, national treatment and most favoured nation principles are provided for by Articles 3 and 4 of TRIPs. Additionally, members are free to determine the appropriate method of implementation of TRIPs. TRIPs does not require a global harmonization of IP laws, it simply sets up a framework within which member states of WTO can create domestic legislature that ultimately results in the efficient protection of IP.

The fifth category deals with transitional arrangements. The TRIPs obligations apply equally to all members but developing countries get a longer period to phase them in. The date of compliance for developed member states was January 1, 1996. For developing states, the date

²⁷ Bernard Sihanya (2006) *Intellectual Property Law teaching materials II, op. cit.*

was January 1, 2000 while for least developed states; the date was January 1, 2006. Kenya is in the category of developing countries,²⁸ but is yet to fully comply. This in turn has created reluctance on the part of international firms investing in the Kenyan economy, especially in areas where it appears that their IP will be jeopardised.²⁹ An example is the reluctance of the giant fast food chain McDonald's to create franchises in Kenya due to what may be cited as inadequate IP protection systems.³⁰

1.3. Forms of intellectual property

As aforementioned, IP has traditionally been broadly divided into the two categories of industrial property and copyright. This distinction was based on the perception that cultural creations differed fundamentally from functional commercial inventions. This distinction has, however, been considerably blurred in the age of information technology and digital products.³¹

There are four primary forms of IP. The first form is patents. A patent awards an inventor the right to prevent others from making, selling, importing or using the protected invention without authorization for a fixed period of time within a country. In return, the society requires that the application be published in sufficient detail to reveal how the technology works, thereby increasing the stock of public knowledge.³² The minimum period of protection required under TRIPs Article 33 is 20 years from the date an application is filed.

Many countries also recognize utility models or petty patents, which award rights of a shorter

²⁸ WTO (2006) "Negotiations, implementation and development: the Doha agenda" at <http://www.wto.org>, accessed 11/04/2006.

²⁹ Gavin Bell Kenya Franchise Association, interview on 12/05/06 at Kengeles Lavington Nairobi. Gavin Bell was the Chairman of the Kenya Franchise Association as well as the Managing Director of the Kengeles Management Group at the time of this interview. He is currently the CEO of African Franchise Partners.

³⁰ Gavin Bell, *op. cit.*

³¹ Jayashree Watal (2002) "Implementing The TRIPs Agreement." *op.cit.*

³² Jayashree Watal (2002) "Implementing The TRIPs Agreement." *ibid.*

duration to small, incremental innovations requiring some investment in design and development.

The second form is the right to industrial designs, which protect the aesthetic aspects of a functional article.³³ TRIPs Article 26(3) requires that designs be protected for a minimum of 10 years.

The third form is trade marks (TM) and service marks (SM), which protect rights in a distinctive mark or name used to distinguish a product, a service or firm. The fundamental objective of TM and SM can be summarised as reduction of consumer search costs and elimination of consumer confusion over product quality and origin.³⁴ TM and SM fulfil these two functions by making a product distinguishable from other similar products. To elaborate further, an example is most laundry washing powders look the same when out of their packaging; they are either blue or white. If these powders were not distinguishable by their TM, consumers would spend a lot of time and money trying to find their preferred brand by way of sampling, until they found the preferred brand. In the process of trying to identify their brand, a consumer may be exposed to an inferior product which he may assume to be from the same source as a superior product, because of lack of a TM. The presence of TM saves the consumer the hassle of searching for his preferred brand and also assures him of the product's quality and origin.

TRIPs Article 18 requires that trade marks be protected for a minimum of 7 years from the date of initial registration, and on each renewal of registration. The Paris Convention (1967)

³³ Jayashree Watal (2002) "Implementing The TRIPs Agreement." *op.cit.*

³⁴ Nicholas Economides, "Trademarks," Stern School of Business, New York University, <http://www.raven.stern.nyu.edu/networks/> last accessed March 2006.

provides for protection of notorious trade marks regardless of registration under Article 6bis. The relevant part of Article 6bis reads as follows: “The countries of the Union undertake, ex officio if their legislation so permits, or at the request of an interested party, to refuse or to cancel the registration, and to prohibit the use, of a trademark which constitutes a reproduction, an imitation, or a translation, liable to create confusion, of a mark considered by the competent authority of the country of registration or use to be well known in that country as being already the mark of a person entitled to the benefits of this Convention and used for identical or similar goods. These provisions shall also apply when the essential part of the mark constitutes a reproduction of any such well-known mark or an imitation liable to create confusion therewith.”

This provision is stipulated to apply *mutatis mutandis* under Article 16 TRIPs which reads as follows:

1. The owner of a registered trademark shall have the exclusive right to prevent all third parties not having the owner's consent from using in the course of trade identical or similar signs for goods or services which are identical or similar to those in respect of which the trademark is registered where such use would result in a likelihood of confusion. In case of the use of an identical sign for identical goods or services, a likelihood of confusion shall be presumed. The rights described above shall not prejudice any existing prior rights, nor shall they affect the possibility of Members making rights available on the basis of use.

2. Article 6bis of the Paris Convention (1967) shall apply, *mutatis mutandis*, to services. In determining whether a trademark is well-known, Members shall take account of the knowledge of the trademark in the relevant sector of the public, including knowledge in the Member concerned which has been obtained as a result of the promotion of the trademark.

3. Article 6bis of the Paris Convention (1967) shall apply, *mutatis mutandis*, to goods or services which are not similar to those in respect of which a trademark is registered, provided that use of that trademark in relation to those goods or services would indicate a connection between those goods or services and the owner of the registered trademark and provided that the interests of the owner of the registered trademark are likely to be damaged by such use.

Article 16 of TRIPs reiterates the position set out by Article 6bis and goes on to provide that a direct link between the trade mark and the product can be established.

A device related to trade marks known as geographical indications (GI) also falls under this category. The functions of GI are to certify that products such as wines, spirits, and foodstuffs were made in a particular place and embody the quality or reputational characteristics of that location. The terms of protection of GI are left to the discretion of the member states with guidance from TRIPs Articles 22, 23 and 24.

The fourth form is copyright, which protects artistic, musical and literary works. Copyright grants exclusive rights to the particular expression of work for a period of time. TRIPs Article 12 provides protection for a period of not less than 50 years from the end of the calendar year of making for works in this category other than photographic works or works of applied art. In some countries such as the United States and some members of the European Union, the minimum period of protection is 70 years. Copyright covers only expressions rather than ideas and therefore provides thinner protection than patents. Rights extend to the reproduction, display, performance, translation, and adaptation of the works. Examples of copyrighted works include books films, music, and computer software. The primary

limitation on copyright protection stems from the fair use doctrine, which defines the conditions under which copying for limited purposes are permitted.³⁵

The TRIPs agreement requires that computer programs be protected at least by copyright under Article 10, under the principle that software code is a literary expression. Countries may vary in the degree to which reverse engineering of computer programs is permitted under the fair dealing or other limitations. Where the computer program constitutes a commercially useful process, a number of industrial countries permit firms to patent them. This policy is pushing patent protection into new areas, including methods of doing business. Another evolution is the tendency towards awarding patents for biotechnological research tools.³⁶

Other categories also protected as IP include designs of integrated circuits. These are more than literary expressions but the inventive step is often minimal, suggesting a compromise between patent and copyright.³⁷ TRIPs Article 38 provides for a 10 year protection term and requires only originality in terms of being the product of original intellectual effort. Other areas considered are special technology like the integrated circuits is the plant breeders' rights (PBRs), which permit developers of new, distinctive and genetically stable seed varieties to prevent others from marketing and using these varieties for a fixed term. Many countries limit these rights through exceptions permitting farmers to use seeds for subsequent replanting and researchers use the seeds for further breeding. For PBRs to be granted, the plant should be a discovery of a naturally occurring process within which a scientific intervention has taken place. The other protectable category is trade secrets, which have proprietary value including production processes or formulas. These may be kept secret

³⁵ Jayashree Watal (2002) "Implementing The TRIPs Agreement." *op.cit.* See also Lionel Bently and Brad Sherman (2004) *Intellectual Property Law*, Oxford University Press New York (2nd Edn).p193.

³⁶ Jayashree Watal (2002) "Implementing The TRIPs Agreement." *op.cit.*

³⁷ Jayashree Watal (2002) "Implementing The TRIPs Agreement." *ibid.*

within the firm but if a competitor learns of them through legitimate means for instance reverse engineering, the originator has no rights to exclude its use.

1.4. Trade marks in the world and in Kenya

As aforementioned, the TRIPs agreement governs the bulk of IP regulation (on an international level), in its member states. The provisions of TRIPs give the definition of trade marks and stipulate the mode of their regulation under Article 15 to Article 21.³⁸ Kenya is currently a member of the WTO and is therefore bound by the TRIPs agreement.

Before the inception of TRIPs the regulation and protection of trade marks was governed mainly by the Paris Convention on Industrial Property 1883 and the subsequent Paris Conventions. The original Paris Convention did not provide for any form of international application for registration in a number of countries, but as early as 1891, some Paris participants were prepared to take this step in the Madrid Agreement³⁹ concerning the Registration of Marks. The agreement was subsequently revised in 1911, 1934, 1958 and an additional Act, 1967. Few countries acceded to the agreement. In 1989, a Protocol to Madrid (so called but effectively a new agreement) was negotiated which offered an alternative method of using the Madrid Scheme.⁴⁰ The new method makes it possible for one member state to apply for protection in some or all the member states to the Madrid Scheme by a single application. Such application is submitted through Kenya Industrial Property Institute (KIPI) as a receiving office, for transmission to the International Bureau of the World Intellectual Property Organization in Geneva, Switzerland. The Protocol which came into operation on April 1, 1996, is more popular, with countries like the UK and the USA acceding to it in 1994 and 2002 respectively.

³⁸ See Chapter 1§1.3.

³⁹ Cornish and Llewelyn, *Intellectual Property. op. cit.*

⁴⁰ Cornish and Llewelyn, *Intellectual Property. ibid.*

The present membership of the Madrid Scheme is approximately 70 countries, Kenya included. Kenya acceded to the Madrid Agreement Concerning International Registration of Marks, and the Protocol relating to that Agreement, with effect from 26th June 1998.

Domestically in Kenya, there has been a system for registration of trade marks since 1901. This system during the colonial period required registration in Kenya as well as the UK for it to have value in Kenya. The current Kenyan legislature in relation to trade marks- the Trade Marks Act Chapter 506 of the Laws of Kenya (Cap 506)- came into force on 1st January 1957. Cap 506 is based on the corresponding English statute, which is over half a century old. The English Act has undergone major reforms since 1938 unlike its Kenyan counterpart, which has had fewer reforms in comparison. An example is the provision of registering distinctive marks under Part A of the trade mark register and registration of marks capable of distinguishing products under Part B. This was the practice in England under the 1938 Trade Marks Act, but the position changed fundamentally in 1994 with the enactment of a new Trade Marks Act that allows a single registration system. According to David Bainbridge in his book *Intellectual Property*⁴¹ the lower threshold, capable of distinguishing, is now the test and it is likely that this will be taken to have the same meaning as before, that is, capable in time of becoming distinctive in use, or not incapable of becoming distinctive, as *per* Sargant LJ in *Davies v. Sussex Rubber Co.*⁴²

Some of the important reforms that the Cap 506 has undergone is the allowance of a multiple class filing system, and a post TRIPs amendment introducing Section 15A which caters for the protection of notorious marks regardless of registration. Section 15A is an

⁴¹ David Bainbridge, *Intellectual Property op. cit.*

⁴² [1927] 44 RPC 412 at 425.

implementation of Article 16 TRIPs.⁴³ Among Kenyan case law authorities demonstrating the application of Section 15A is the case of *Saudia Arabian Airlines Corporation v. Saudia Kenya Enterprises Limited*.⁴⁴ Even though this case was decided prior to the addition of Section 15A to Cap 506, it demonstrated the protection of notorious marks.

The importance of trade marks in Kenya has become more evident with the growth of both the population and industries. KIPi, under Cap 506, is charged with the registration of trade marks and service marks in Kenya. This by extension means that KIPi is also responsible for the protection of these marks. This protection applies to all registered trade marks regardless of their origin.

1.4.1. Brief history of trade marks

Trade marks have existed since the pre-Christian era. The marking of goods for various purposes, including distinguishing them from those of other traders, can be traced back to ancient times. Similarly, the existence of rules governing the use of such marks goes back to the medieval craft guilds.⁴⁵ Some of the earliest trade marks are dated back to the 1600s B.C.⁴⁶ The Chinese Shang dynasty mark is dated 1600 B.C. Another example is the Egyptian Ramses II cartouche found on a sun-dried mud and straw brick, Dynasty 12, 1279 - 1212 B.C. Later marks include a mark found on a Chinese Ming bowl dated 1600 A.D.

Although the application of distinguishing marks to goods is has a long history, the law relating to trade marks is relatively young, going back to the early part of the 19th century.⁴⁷

The idea evolved that a mark which has become distinctive of a particular trader's goods, and

⁴³ See Chapter 1 §1.3.

⁴⁴ Civil Appeal 47 of 1984.

⁴⁵ WIPO (2006) "Trademarks and Branding Strategies of SMEs" at <http://www.wipo.int>. accessed 01/07/06.

⁴⁶ WIPO (2006) "Trademarks and Branding Strategies of SMEs" *op. cit.*

⁴⁷ David Bainbridge, *Intellectual Property*, *op. cit.*

so attracted valuable goodwill, may be considered as a type of property, now described as IP. In the middle of that century there also developed the right to take action in the courts against infringement of a trade mark, even where there was no intention to deceive on the part of the infringer. The usefulness of such an action was, however, limited by the need for a trader to prove that the mark concerned was in fact capable of distinguishing his goods, and that it belonged to him.⁴⁸

Famous marks that pioneered the protection of trade marks include the Edouard Manet Un Bar au Folies Bergere, 1882.⁴⁹ Among the first forms of protection were the Paris Convention on Industrial Property of 1883 and the subsequent Paris Conventions including 1967. These were followed by other agreements, which culminated in TRIPs as explained in section 1.4. of this Chapter.

1.4.2. Nature of trade marks and their subsistence

A trade mark seeks to answer the question what is in a name, mark, sign, signature, symbol, sound or shape or smell.⁵⁰ A trade mark may include one or a combination of marks, signs, signatures, symbols, sounds, shape or smells.

David Bainbridge in his book *Intellectual Property*,⁵¹ states that the functions of trade marks are: first to protect business reputation and goodwill, and secondly to prevent the consumer from confusing a quality product with an inferior one thereby protecting the consumer from deception. The third function is to inform the consumer as to the identity of the product.

⁴⁸ See <http://www.intellectual-property.gov.uk>, the official UK Government website for information on Intellectual Property.

⁴⁹ WIPO (2006) "Trademarks and Branding Strategies of SMEs" *op. cit.*

⁵⁰ Bernard Sihanya (2006) *Intellectual Property Law teaching materials III Lecture to LLB IV MODULE II on 07/03/06* University of Nairobi, Faculty of Law. I was a student in this class and the abovementioned teaching materials used are on file at innovative Lawyering Nairobi.

⁵¹ David Bainbridge, *Intellectual Property*, *op. cit.*

Cornish and Llewelyn in their book *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*,⁵² state the functions of trade marks as origin function, quality or guarantee function, and investment or advertising function. They argue that in order for a trade mark to fulfil these three functions, it must be protected. Ben Sihanya adds a fourth function of trade marks as helping to confirm and fortify consumer expectations.⁵³

According to Nicholas Economides, in his article "Trademarks," trade marks have the economic function of facilitating and enhancing consumer decisions, thus translating into sales for firms.⁵⁴ These sales are an incentive for production by these firms.

In most jurisdictions, for a trade mark to be protected, it must be registered or considered notorious. Notorious trade marks, for example Coca Cola, are protected regardless of registration. Trade marks rest on registration and use according to Ben Sihanya. Kenya and other jurisdictions have traditionally emphasized registration before use while USA has emphasized on use before registration. Under Section 5 of Cap 506, an infringement action could not be brought unless the trade mark was registered. This was however subsequently revised with regards to notorious marks, by Section 15A.⁵⁵

Ben Sihanya further opines that only registrable trade marks may be registered provided they are not prohibited and are not contrary to public order. Sections 20 – 22 of Cap 506 deal with registration of trade marks. Under Cap 506, there are absolute grounds and relative grounds on registrability. Absolute grounds arise where the trade mark is not registrable *ab initio* or *per se*. in this case, the registrar (in the case of Kenya, the Kenya Industrial Property

⁵² Cornish and Llewelyn, *Intellectual Property. op. cit*

⁵³ Bernard Sihanya (2006) *Intellectual Property Law teaching materials III, op.cit.*

⁵⁴ Nicholas Economides, 1997, "Trademarks," *op.cit.*,

⁵⁵ See Chapter 1§1.4.

Institute) has no discretion. He is mandated not to register, and will therefore not register the mark. He is banned by statute, or a treaty to which Kenya is a party or the Constitution. An example is the sign of five rings as well as the name IOC which belong to the International Olympic Committee (IOC) cannot be registered in Kenya by any other entity except the IOC.⁵⁶ All names of organizations are included in this category. Also included are words which are not capable of distinction, for example trying to register the word “computer” as a trade mark for computers. In a case like this, what is permitted is a word taken out of context in order to distinguish a product for example the trade mark “Apple” used for computers. Relative grounds arise when the Registrar has the discretion to accept or refuse registration. The registrar takes several issues into consideration including whether or not the mark is confusingly similar to another; is there likelihood of confusion; is the mark misleading, and whether there is a question of tarnishment.⁵⁷

Registration is divided into two broad categories in Kenya; marks which are distinctive for example Kenya Airways and Johnny Walker, and marks capable from distinguishing the products from others for example Blue Band and Gold Band for margarines in Kenya. As aforementioned, distinctive marks are registered in Part A of the register while marks capable of distinguishing are registered in Part B of the register.

1.4.3. Ownership of trade marks and their infringement ✨

A trade mark owner has exclusive rights over his trade marks. These rights are infringed by the use of the trade mark without consent. Section 9(1) and Section 10 of the United Kingdom (UK) Trade Marks Act 1994, provide for the trade marks owner’s exclusive right

⁵⁶ Bernard Sihanya (2006) *Intellectual Property Law teaching materials III. op.cit.*

⁵⁷ Bernard Sihanya (2006) *Intellectual Property Law teaching materials III. ibid.*

and what amounts to infringement. The rights have effect from the date of registration.⁵⁸ This is the date of the filing the application in accordance with section 40(3).⁵⁹

Actions amounting to infringement include passing off which entails misrepresenting a mark and unfair competition. Unfair competition includes such activities as carrying out espionage, inducing employees to reveal trade secrets, and encouraging defection of technical employees to produce their own versions of a product based on proprietary information. Definitions of unfair competition vary considerably across countries.

According to Lionel Bently and Brad Sherman in their book *Intellectual Property Law*,⁶⁰ under the UK Trade Marks Act, circumstances in which a trade mark may be infringed include:

- a. Where marks are identical and the goods and services are identical;
- b. Where the marks are identical and the goods and services are either identical or similar and there is a likelihood of confusion, which includes the likelihood of association, with the registered mark;
- c. Where the marks are similar, and the goods and services are either identical or similar and there is a likelihood of confusion, which includes the likelihood of association, between the marks;
- d. Where the marks are identical or similar, and the goods and services are not similar and where the registered trade mark has a reputation in the UK, and use of the

⁵⁸ UK Trade Marks Act 1994, Section 9(3).

⁵⁹ UK Trade Marks Act 1994.

⁶⁰ Lionel Bently and Brad Sherman (2004) *Intellectual Property Law*, Oxford University Press New York (2nd Edn). Lionel Bently is Professor of Law at King's College, London, and from October 2004, Herchel Smith Professor of Intellectual Property, university of Cambridge. Brad Sherman is Professor of Law at Griffith University, Brisbane, Australia, and Director of the Centre for Intellectual Property in Agriculture at the Australian National University and Griffith University.

defendant's mark would take unfair advantage of, or be detrimental to the distinctive character or repute of the registered trademark.

Instances c. and d. are common in Kenya and may be a problem that may deter potential franchisors from investing in the country.⁶¹

1.4.4. Remedies for infringement of trade marks

According to Benard Murunga in his presentation paper "In Court Everyday: A Legal Practitioner's Perspective On Litigating Trade marks, Brand Management and Franchising,"⁶² There are several remedies available in Kenya, to a trade mark owner who discovers that their mark or get up has been or is being infringed. These remedies include pre-litigation and litigation remedies. Under the pre-litigation remedies, an aggrieved party may engage a commercial investigator to investigate the particulars of the infringement, and then write a "Cease and Desist" letter to the infringers or instruct a firm of advocates on his behalf. The cease and desist notice is usually also printed in the local daily press.

The second pre-litigation remedy is opposition. Here an aggrieved party may take part in opposition proceedings at the Registry of Trade Marks if the party feels that another has registered a trade mark closely resembling its own.

The third pre-litigation remedy is expungement. Here the aggrieved party can move the Registry by way of expungement proceedings. Expungement proceedings deal with already

⁶¹ See *Beiersdorf AG v. Emirchem Products Limited* [2002] eKLR and *Saudia Arabian Airlines Corporation v. Saudia Kenya Enterprises Limited* [1986] eKLR for instance c and *British United Provident Association v. BUPA(Kenya) Ltd* [2001] eKLR for instance d. These cases were accessed at <http://www.kenyalaw.org>. last accessed 06/10/07.

⁶² Benard Murunga, (2006), "In Court Everyday: A Legal Practitioner's Perspective On Litigating Trade marks, Brand Management and Franchising," Nairobi, 9th March 2006. Benard Murunga is an Advocate of the High court of Kenya.

registered marks that closely resemble an aggrieved party's marks. The provisions dealing with expungement are under section 29 of Cap 506.

In terms of litigation, an aggrieved party has recourse by way of bringing an action for passing off or infringement. Where there is a franchising contract, an aggrieved party may sue for breach of contract as most franchise contracts include a clause of non-infringement of the franchisor's marks. Remedies for infringement shall be discussed further in Chapter 3 under rights of franchisors.

From the discussion in this Chapter, I have been able to conclude that Kenya does indeed have a functioning legal system governing IP. There is specific legislation covering trade marks in the form of Cap 506. Kenya is also subject to the provisions of the TRIPs agreement. Several amendments have been made to the Cap 506 in an attempt to domesticate the TRIPs agreement and in the process harmonize Cap 506 with international standards.

Major changes include:

- amendment of the law to recognize the Madrid system which Kenya acceded to in 1998.
- Change of the initial term of a trade mark from 7 years to 10 years.
- Change of the subsequent term of a trade mark from 14 years to 10 years.
- Removal of the requirement for association of trade marks.
- Removal of the requirement for registered user of a Trade marks.

These developments indicate that Kenya is making an effort towards strengthening her trade mark laws. However, further changes are required. These changes include the introduction of a single registration system, to ease the process of registration.

With regards to franchising, the Kenya trade mark law only serves to protect the trade marks of the franchisor by inference and application of relevant provisions of Cap 506. It must be noted however that a franchise agreement goes beyond the intellectual property related to the franchise.⁶³ Kenyan trade mark law does not address the other legal aspects of franchise agreements.

In the next Chapter, the concept of franchising is analysed and explained, first from an international perspective then from a domestic perspective.

⁶³ Franchise Agreements involve branches of law including contract law and company law. This issues are discussed further in Chapter 2 § 2.2.

CHAPTER 2

FRANCHISING

This Chapter examines the concept of franchising and legal issues related to it with primary focus on trade mark law drawing from the discussion in Chapter 1. Through an examination of the development of trade mark law in Chapter 1, it was my conclusion that attempts are being made to strengthen trade mark laws in Kenya. In this Chapter, the place of franchising in the Kenyan economy is also examined.

2.1. Definition

The World Intellectual Property Organization (WIPO) publication: *WIPO Intellectual Property Handbook: Policy Law and Use*⁶⁴ states that franchising may be described as an arrangement whereby one person (the franchisor), who has developed a system for conducting a particular business allows another person (the franchisee) to use the system. The franchisee uses the business system in accordance with the prescriptions of the franchisor. In exchange, the franchisor receives compensation. The relationship is a continuing one as the franchisee operates in accordance with standards and practices established and monitored by the franchisor with his continuing assistance and support. The franchising arrangement therefore relates to a system which the franchisor allows or licences the franchisee to exploit. This system may be referred to as the franchised system. The franchised system is a package compiling IPR relating to various forms of IP to be exploited for the sale of products to end users.

⁶⁴ WIPO (2004) "*WIPO Intellectual Property Handbook: Policy Law and Use*" at <http://www.wipo.int>, accessed 11/07/2006.

According to Anthony Okulo in his presentation paper “Legal Challenges Facing Franchising In Kenya”⁶⁵ franchising may be defined as a business system whereby a trade mark owner (the franchisor) authorises a second party (the franchisee) to engage in business using the franchisor’s trade mark. The franchisor lends his trade mark or trade name and a business system to the franchisee. In return, the franchisee pays a royalty and often an initial fee for the right to do business under the franchisor’s name and system. The contract binding the two parties is known as a franchise. The term franchise is also used to describe the actual business the franchisee operates.

Gillian Hadfield in her article “Problematic Relations: Franchising and the Law of Incomplete Contracts,”⁶⁶ states that typically, the franchisor contributes nothing beyond the design for the product and relation, perhaps represented by a trade mark and organizational capital, whereas the franchisee owns the bulk of the assets that contribute to producing the fruits of the relationship. The franchisee’s assets are often the factors of production save for a degree of the entrepreneurial skill.

According to the *WIPO Intellectual Property Handbook: Policy Law and Use*⁶⁷ franchising is characterised by several factors. The first characteristic of franchising is that a franchisee is licensed to use the system in return for an agreed payment. Where the franchised system is to be exploited at a particular location such as a franchised restaurant or shop, that location is usually referred to as a franchised unit. The second characteristic is that the franchisor and the franchisee have an ongoing interactive relationship. This relationship comprises multiple sales of the franchised product by the franchisee over a period of time. The franchisor on his

⁶⁵ Anthony Okulo (2006) “Legal Challenges Facing Franchising In Kenya,” Nairobi, 9th March 2006. Anthony Okulo is an Advocate of the High Court of Kenya.

⁶⁶ Gillian K. Hadfield (1990) “Problematic Relations: Franchising and the Law of Incomplete Contracts” *Stanford Law Review*, Vol. 42, No. 4. (Apr. 1990), pp. 927-992.

⁶⁷ WIPO (2004) “*WIPO Intellectual Property Handbook: Policy Law and Use*” *op.cit.*

part gives continuous assistance to the franchisee in establishing, maintaining and promoting the franchised unit. The franchisee is continuously obligated to pay fees to the franchisor for the use of the franchised system or to compensate the franchisor for providing on going management services.

The third characteristic is the franchisor's right to prescribe to the franchisee the manner of operating the business. The franchisee is obligated under the franchise agreement to abide by the franchisor's directives with regard to the business. These directives may include quality control, protection of the system, territorial retractions, operational details and a host of other regulations governing the conduct of the franchisee in relation to the franchise.

2.2. Franchising agreements

Franchise agreements are in reality contracts between the franchisor and the franchisee. They are the main legal framework within which the franchise is managed. According to Annex 3 of The International Institute for the Unification of Private Law (UNIDROIT) publication, *The UNIDROIT Guide To International Franchise Agreements*⁶⁸, (hereafter referred to as Annex 3) a healthy commercial law environment is vital for franchising, and without it, franchising cannot function. The Annex goes further to define a healthy commercial environment as one with general legislation on commercial contracts, with an adequate company law system, where there are sufficient notions of joint ventures. In addition, the annex states that a functional IP system must in place and enforced, and that business entities should be able to rely on ownership of trade marks and know how as well as on confidentiality agreements.

⁶⁸ UNIDROIT (2006) "*The UNIDROIT Guide To International Franchise Agreements*," at <http://www.unidroit.org>, accessed 26/05/06.

Annex 3 further states that aside from the general commercial law and IP laws, franchising is governed by several other areas of law. Under Annex 3, these laws can be split into two main categories. The first category comprises of laws and regulations that are applicable to contracts in general. The second category comprises of specific contract legislation, in this case franchise specific legislation where it exists. It is important to note that Intellectual property rights are the basis upon which the franchise relationship is built. They are therefore of fundamental importance. In international relationships the international conventions and other regulations of international origin must be taken into account.⁶⁹

In the first category, we have general contract law. All franchise agreements are subject to contract law. In countries that separate the regulation of commercial contracts from that of other contracts, some aspects of the agreement will be subject to provisions in the laws or codes that regulate commercial contracts.⁷⁰

Agency law and the law regulating other distribution contracts is another class of law falling in the first category. This is because some aspects of the relationship between the franchisee and the franchisor are governed by agency law even though the systems of agency and franchising are distinct from each other. Some distributorship laws also touch on aspects of franchising.

Leasing and security interests are also in the category of general laws. The reason for this is equipment and premises might be leased and security interests might be involved. This is particularly the case where specific equipment is needed for the franchise and where the franchisor provides that equipment.

⁶⁹ UNIDROIT (2006) "*The UNIDROIT Guide To International Franchise Agreements*," *op.cit.*

⁷⁰ UNIDROIT (2006) "*The UNIDROIT Guide To International Franchise Agreements*," *ibid.*

The fourth class of the first category laws is law relating to financial investments. Financial investments will be covered by the legislation that specifically regulates those matters.⁷¹

The fifth class of these laws is competition law. The terms of the franchise agreement that might be covered by competition law are those that relate to the price that a franchisee should charge for the products or services it offers and those relating to the exclusive rights granted franchisees in a franchise relationship, as they might give rise to suspicions of market sharing and concerted action between the members of the network. The problem in franchising is ensuring that the franchisee is given the best possible protection to develop its territory, for example by being granted exclusive territorial rights, but without the terms of the agreement falling under the terms of the competition legislation. The drafters of the franchise agreement should therefore be careful to take into consideration the competition laws of the particular jurisdiction.⁷²

Fair trade practices law is the sixth class of laws in the first category. This class of laws is relevant especially when considering the post-term non-competition clauses and in relation to the franchisors' options to reserve the right to distribute their products through alternate channels. Also relevant is legislation dealing trading schemes. An example is the 1996 Trading Schemes Act adopted in the United Kingdom (UK) which covers pyramid selling. This law has a direct effect on some certain types of franchising in the UK, especially the area of sub-franchising.

⁷¹ UNIDROIT (2006) *"The UNIDROIT Guide To International Franchise Agreements," op.cit.*

⁷² UNIDROIT (2006) *"The UNIDROIT Guide To International Franchise Agreements," ibid.*

Corporate law is the seventh class of laws in the first category. The corporate law form the franchisor and the franchisees adopt is relevant, in particular for questions of liability and taxation.

The legal taxation system is the eighth class of laws in the first category. Taxation regulation is of considerable importance, not the least because taxation issues often decide the corporate form the parties will adopt, the franchisor for its presence in the host country and the franchisee for its unit. Issues such as who has to pay withholding taxes need to be regulated in the franchise agreement.

Property law which is the ninth class of the first category laws is relevant especially in relation to the assets of the franchise. It is particularly relevant in case of termination of the agreement. Property law will also need to be considered in relation to the assets of the franchise. It is particularly relevant in case of termination of the agreement.

Legislation on consumer protection and product liability is the tenth class and is of relevance particularly where the possible liability of the franchisor for products or services sold by the sub-franchisee or franchisee is concerned. Consumer protection must be considered at two levels: firstly, at the level of liability towards the consumer in the ordinary sense, secondly at the level of liability towards the sub-franchisor or sub-franchisee. At the latter level what should be considered is whether the sub-franchisor or sub-franchisee can itself be regarded as a consumer and therefore be covered by the consumer protection statutes. The question is whether the reach of those statutes can be viewed as broad enough to protect sub-franchisors or sub-franchisees that are not purchasing items for consumption, but are making an

investment and are therefore traditionally not thought of as consumers, even if they might be treated as consumers for the purpose of the statutes.⁷³

Insurance law which is the eleventh class is relevant as master franchise agreements will often require sub-franchisors to take out insurance with the franchisor as beneficiary.

Labour law is the twelfth class. The issues considered for this class of laws includes in the first instance the relationship between the franchisor and the franchisee. The second issue to be considered is the relationship (if any) between the franchisor and the employees of the franchisee, for example where the franchisor retains the right to approve the employees of the franchisee. Thirdly the issue as to the position of the employees of the franchisee in the franchise system, which includes questions such as the right of the employees to be consulted on important business decisions, is to be considered. An example of such a labour law is the *European Council Directive 94/95 on the establishment of a European Works Council or a procedure in Community-scale groups of undertakings for the purpose of informing and consulting employees*.⁷⁴

The law regulating the transfer of technology is the thirteenth class. Franchising may be covered by the broad definition of technology transfer contained some domestic legislations. If the technology transfer legislation is found to apply to the franchise agreement concerned, the latter may have to be approved by the local authorities responsible for contracts for the transfer of technology and registered in the appropriate register. An example of such regulations includes the recent European Regulation on technology transfer agreements,

⁷³ UNIDROIT (2006) "*The UNIDROIT Guide To International Franchise Agreements*" *op.cit.*

⁷⁴ OJ EEC L 254/64 of 24 October 1995.

which was adopted on 31 January 1996. It replaced the existing regulations on patent and know-how licensing agreements.⁷⁵

Legislation regulating foreign investments, currency control regulations, and import restrictions such as quotas is the fourteenth class of laws to be considered. Legislation regulating joint ventures is the fifteenth class of laws to be considered. This is because joint ventures are frequently used for the international expansion of franchise systems. This is the case particularly in situations where the local partners suffer from a lack of financial means as is the case in many developing countries, Kenya included.

Industry specific laws or regulations are the final class of laws in the first category. Any laws or regulations specific to the trade sector involved (for example health regulations for food franchises) need to be carefully considered in each particular case.

As aforementioned, the second category of laws relevant to franchising is specific legislation dealing solely with the area of franchising. Although an increasing number of states are considering the introduction of franchise-specific legislation (Kenya included),⁷⁶ still only very few regulate franchising. Furthermore, where it exists, the legislation adopted refers to simple domestic franchising and not to international franchising. Its applicability to international franchise transactions, to master franchise agreements and other arrangements, therefore needs to be assessed. In part, this lack of franchise-specific legislation is due to the complexity of the relationship and to the great number of areas of law involved in a franchise

⁷⁵ Regulation (EEC) No 2349/84 of 23 July 1984 on the application of Article 85(3) of the Treaty to certain categories of patent licensing agreements (OJ EEC L 219/15 of 16 August 1984), as last amended by Regulation (EC) No 2131/95 (OJ EEC L 214/6 of 8 September 1995); and Regulation (EEC) 556/89 of 30 November 1988 on the application of Article 85(3) of the Treaty to certain categories of know-how licensing agreements (OJ EEC L 61/1 of 4 March 1989).

⁷⁶ Gavin Bell of Kenya Franchise Association is among the proponents of such legislation. Gavin Bell Kenya Franchise Association, interview on 12/05/06 at Kengeles Lavington at Nairobi. *op.cit.*

relationship. The existing laws deal with various area of franchising in a piecemeal fashion. Examples are laws dealing solely with disclosure legislation and not legislation regulating the relationship between the parties. Other laws such as the European Union regulation of franchising deal solely with competition law issues.

In Kenya, franchising agreements are regulate through a combination of the law of contract, company law and laws relating to IP such as trade mark law and copyright law. As the franchise industry is growing, there is increasing a need for a single legislation to govern franchising. The reason for this is that it is difficult to crate a linkage between all the different laws involved. Dr. Sihanya opines that there is a need for a clear, specific law to handle franchising relationships.⁷⁷ This law should also cover consumer protection, quality control and product liability.

With a varying degree of detail disclosure laws will require the franchisor to provide the prospective franchisee with information on a number of points that will enable the franchisee to make an informed decision on whether or not to enter into the agreement. Information that must be provided includes firstly the franchisor and the directors of the enterprise as well as the history of the enterprise. Secondly, the potential franchisee needs to know the legal constitution of the enterprise and the intellectual property concerned. Thirdly, the financial situation, with audited financial statements for the two or three preceding years should be provided. Fourthly, a potential franchisee needs to know the other franchisees in the network. Fifthly, information on the franchise agreement, such as the duration of the agreement, conditions of renewal, termination and assignment of the agreement should be given. Lastly, information on any exclusivity ought to be provided to the potential franchisee.

⁷⁷ Wanjiru Waithaka (2007) "Legal obstacles that slow down the growth of franchising in Kenya," *Business Daily* (Nairobi), 15/05/07. p. 21. (Ms Waithaka was quoting Dr. Ben Sihanya on the obstacles to and legal strategies for franchising).

It should be noted that although it is not sanctioned by law, there is also an extensive duty on the part of the prospective sub-franchisor or franchisee to disclose all relevant information to the franchisor, so that the franchisor can evaluate whether or not the prospective sub-franchisor or franchisee fulfils the requirements to become a member of the network. This exchange of information is essential for the building up of trust between the parties, which is a prerequisite for the success of the enterprise.

Apart from the aforementioned categories of law, Annex 3 also states that there is voluntary regulation of franchising. A number of franchise associations, both national and international, have adopted Codes of Ethics that are to regulate the conduct of their members. These Codes of Ethics often also deal with disclosure, albeit in a more summary manner: in general they provide that prospective franchisees have to be provided with accurate and full disclosure, but do not contain detailed provisions as to what is to be understood thereby.

2.2.1. Types of franchising agreements

According to the *WIPO Intellectual Property Handbook: Policy Law and Use*⁷⁸ types of franchises can be examined from one broad category referred to as 'business format franchise'. This broad category comprises a number of variations. These variations may consist of changes in the nature of the franchised system, the scope and content of the license granted, the nature or object of the ongoing relationship and the scope and degree of supervision exercised by the franchisor over the manner in which the franchise is exercised.

A business format type of franchise may be described as one characterized by an ongoing business relationship between franchisor and franchisee. This relationship includes not only

⁷⁸ WIPO (2004) "*WIPO Intellectual Property Handbook: Policy Law and Use*," *op.cit.*

the product, service and trademark, but the entire business format itself—a marketing strategy and plan, operating manuals and standards, quality control, and continued two-way communications. Based on function, franchises may be categorized into three principal types: processing franchises, distribution franchises and service franchises. Franchises could also be categorized in terms of the possible relationship existing between franchisor and franchisee. These include relationships like those between manufacturer and wholesaler, manufacturer and retailer, wholesaler and retailer and service industry and retailer.

In a processing franchise, sometimes called a “manufacturing” franchise, the franchisor supplies an essential ingredient or technical knowledge to a processor or manufacturer. The franchisor will grant the franchisee authorization to manufacture and sell products under the marks of the franchisor. In certain instances the franchisee may further be licensed to use trade secret information or patented technology held by the franchisor, apart from which he may be provided with training and/or information relating to the marketing, distribution and servicing of the product. Such franchises are common, for example, in the restaurant and fast-food industry.

In a service franchise, the franchisor develops a certain service which is to be rendered by the franchisee, under the terms of the franchise agreement, to his customers. An example of a service franchise would be one involving the provision of automobile tuning or repair services, or the provision of credit card services.

In a distribution franchise, the franchisor (or someone else on his behalf) manufactures the product and sells it to the franchisees. The franchisees then sell the products to customers, under the franchisor’s trademark, in their own geographical areas. For example, the

distribution of automobile fuel, cosmetics or consumer electronics can be carried out under franchises.

An important part of the franchising agreement is the structure to be used to operate the franchise. The type of structure chosen for a franchise agreement may have a bearing on the manner in which a franchisee or a master franchisee is legally organized. The *WIPO Intellectual Property Handbook: Policy Law and Use*⁷⁹ (hereafter referred to as ‘the handbook’) states that making a choice between the different possible structures depends very much on the particular circumstances of the franchisor and the franchisee and the nature of the franchise. Factors to be taken into consideration include: the franchisor’s reasons for franchising, the resources of the franchisor, the size and resources of the master franchisee or franchise developer, the nature of the market to be served (including its location, foreign or domestic, and its relative importance to the franchisor).

One of the structures described by the handbook is unit franchising. According to the handbook, it is the most straightforward way in which franchising can be carried out, because it involves direct relations between the franchisor and the franchisee. In this relationship, the franchisor enters into a franchise agreement directly with the franchisee. In domestic situations— where the franchisor and franchisee are in the same country—unit franchising is the most commonly used structure. A good example of local unit franchising in Kenya is the Kengeles franchise. However, where the franchisor and franchisee are located in different countries, linguistic, cultural, commercial, legal, political and economic differences between the countries may make it necessary to establish a local presence in the franchisee’s country

⁷⁹ WIPO (2004) “*WIPO Intellectual Property Handbook: Policy Law and Use*,” *op.cit.*

in the form of a master franchisor, or to engage in multiple-unit franchising through a local subsidiary or a joint venture.

The alternative to establishing such a local presence is for the franchisor to establish within his own organization the expertise that will enable him to adapt his franchise to the needs of each of the local markets in which he wishes to operate. While this approach maximizes the franchisor's supervision of the way in which the franchise is implemented, it significantly increases the administrative burden, and hence the cost, of operating in other countries and would detract from one of the major advantages of franchising, which is not to divert resources to establishing business operations abroad.

Territorial franchise is the second structure described by the handbook. This structure is suitable for franchise agreements which aim at covering a substantial territory or geographical area by setting up, simultaneously or successively, a number of units, shops or outlets, over an agreed period of time. Territorial franchise is manifested in two forms: franchise developer agreement and the master franchise agreement. In some case, the two may be combined.

A franchise developer agreement links the franchisor directly with the franchisee, who is expected to open and operate several units. This franchise will include a "development agreement" whereby the franchisee is required to develop the assigned territory by establishing a number of franchise units or outlets which he will usually own directly. In this case the franchisee will not sub-franchise out to third parties. An example of a company using this structure is the international fast food chain Mc Donald's. Generally this agreement will include a schedule setting out the time frame for establishing the franchise units and

developing the assigned territory. The individual units opened by the franchisee under this type of structure would not have independent legal standing, and could be divisions or branches of the franchisee's enterprise.

In a master franchise agreement the franchisor grants another party, usually called the "master franchisee", rights (which may be exclusive) for a given geographical area. The master franchisee is given the right, by the franchisor, to grant franchises to third parties, usually called "sub-franchisees", to exploit fully the potential business opportunities in the larger geographical area. It may be agreed that some of those sub-franchisees will run more than one franchise unit, in which case the sub-franchise agreement is called a "multi-unit franchise." A master franchise agreement allows a franchisor to delegate the exploitation of a geographical area to another person, the master franchisee, in situations where that geographical area is remote from or little known to the franchisor, or where it is found to be convenient for business strategy purposes. This approach to franchising is particularly important in international franchising, where a franchisor may wish to establish franchise operations in a given country, in which he may have no business experience; but even where this is not the case, it may simply be a choice of business strategy. the franchisor's degree of control over the manner in which the franchise is implemented, in the country in which a master franchisee is established, is often regulated by provisions in the master franchise agreement, specifying the latitude that the master franchisee has for making alterations to the franchised system in order to accommodate local needs.

As aforementioned, a franchise agreement may be based on a combination of the structures mentioned above. An example is a combination of a master franchise, under which a number of independent sub-franchisees will be established. This master franchise then includes a

franchise developer agreement under which the same master franchisee, or one of his sub-franchisees, is additionally committed to open a number of his own units in the same territory. A master franchisor could also be mandated to conclude franchise development agreements with one or more of the independent franchisees under the master franchise.

2.2.2. Typical Provisions in a Franchise Agreement

The terms of a typical franchise agreement must conform to the appropriate national laws, and cover the rights and obligations of both franchisor and franchisee. The handbook provides that on the franchisor's side, obligations may include the provision of an operating manual, training, assistance with opening the franchised establishment, and continued support.

On the franchisee's side, obligations include the payment of fees, compliance with quality control requirements, observance of an agreed degree of confidentiality and of exclusivity, and possibly the provision of a step-by-step schedule for the development of the franchise.

The more general terms to be found in other types of agreements, such as provisions on breach of agreement, transfer of agreement and termination, also have their particular application between franchisor and franchisee.

According to Gerd F. Kunze in his presentation "Licensing and franchising: making the most of a mark",⁸⁰ a franchise agreement typically includes the following elements: first, the franchisor and the franchisee are independent entities. Second, the franchisor grants to the franchisee the right to use the franchisor's distinctive trade dress, which may and

⁸⁰ Dr. Gerd F. Kunze (2003) "Licensing and franchising: making the most of a mark," WIPO/TM/BEY/03/6, Beirut March 2003 at <http://www.wipo.int>, accessed 01/07/2006. Dr Kunze is an Intellectual Property Consultant of Counsel, Walder Wyss & Partners Zurich, Switzerland Adjunct Professor, Franklin Pierce Law Center, Concord NH, USA.

generally will include one or more trademarks (service marks) and advertising or other commercial symbols, and provides technical and commercial know-how and information. Third the franchisee undertakes to use what has been granted by the franchisor under a uniform marketing plan or system prescribed in substantial part by the franchisor. Fourth, the franchisee is required to fulfil certain quality requirements, and fifth, the franchisee must pay royalties.

2.3. Franchising as in incomplete contract

It has been argued that franchising is a long term transfer of technology relationship, that it is a relational contract as opposed to a spot contract.⁸¹ A spot contract is a complete contract whereas a relational contract is incomplete. A spot contract is one whereby there is an immediate exchange between the buyer and seller. In event that the transaction does not go as anticipated, losses lie where they fall, and each party picks itself up and moves on. A relational contract is one done based on trust built over a long period.

In the area of franchising, parties to the agreement cannot conclude complete contracts regarding all relevant circumstances. This is because transaction costs are too high to specify in the contract. The parties therefore end up with a relational contract. The advantage of a relational contract is that it may adjust to circumstances for example change of market structure. An example of change of market structure in a franchise arrangement is the distinction of a newer product that enters the market and successfully takes over an existing profitable niche from older products. This scenario can be observed in the Kenyan fast food market where foreign brands such as “Nandos” and “Steers” have taken over the niche formerly occupied by “Wimpy” and “Kenchic”. More often than not, the franchisee bears the

⁸¹ Gillian K. Hadfield (1990) “Problematic Relations: Franchising and the Law of Incomplete Contracts,” *op.cit.*

negative effects of the incomplete contract. For example is a franchised product loses distinction, the franchisee is still expected to pay the same amount of royalties as per the franchise agreement by the franchisor. When the franchise deal finally ends, the franchisor is the sole beneficiary as total ownership of the trade mark and any IP rights revert to him. The franchisee is often left empty handed having developed and marketed a product that he does not own any rights to.

The other area in which franchising may be viewed as an incomplete contract is in the area of termination clauses. According to Jonathan Klick, Bruce Kobayashi, Larry Ribstein in their article "Incomplete Contracts and Opportunism in Franchising Arrangements: The Role of Termination Clauses,"⁸² as with any incomplete contract, the franchise contract has the potential to generate *ex post* opportunism both on the part of the franchisor and the franchisee. Many franchisors create self operational termination clauses as way of exerting greater control over the franchisee. This may be vital in order to ensure that a franchisee works hard to maintain the goodwill of a product. In some cases however, franchisors may use such clauses to expropriate the returns from a franchisee's investment in market discovery and development. The franchisor conducts the expropriation by terminating contracts in those markets that turn out to be unexpectedly profitable. This allows the franchisor to service the market itself without having to split revenues with a franchisee⁸³ or resell the franchise at better term thereby gaining a greater market presence. The franchisee is utterly helpless in such a scenario.

⁸² Jonathan Klick, Bruce Kobayashi, Larry Ribstein (2006) "Incomplete Contracts and Opportunism in Franchising Arrangements: The Role of Termination Clauses," *Journal of Law and Economics* January 9, 2006.

⁸³ This is common especially in cases where there is contract mixing. Contract mixing is a situation where by the franchisor directly controls some of the units for example the Kenyan restaurant chain Kengeles, while other units are run by franchisees.

2.4. Ownership rights in franchising

The parties of a franchising agreement each own what they bring to the business. For example the franchisor owns all of the IP which he licences the franchisor to use. The franchisee on the other hand owns knowledge of the market where the franchise is to be set up. Josef Windsperger in his article "Ownership Rights In Franchising Firms,"⁸⁴ opines that such assets represent proprietary knowledge which cannot be easily transferred because investments in such assets are costly if not impossible to monitor. The franchisor faces the problem of maximizing the returns to his intangible assets when they are dependent on local intangible investments of the franchisee. The franchisee therefore bears a substantial residual risk for local outlets, and he has the residual rights of control of the local promotion and services. These investments cannot be specified in the contract and this makes asset ownership critical to market success of the product.

Windsperger further states that by application of the incomplete contracting theory, allocation of ownership rights depends on the distribution of intangible assets between the franchisor and the franchisee. This means that the higher the franchisor's (or franchisee's) intangible assets relative to the franchisee's (or franchisor's), the more ownership rights should be transferred to the franchisor (or franchisee). A local example would be the Kengeles and Steers restaurant franchises. Kengeles Ltd has a locally established brand name and strong market presence, whereas Steers has a strong international presence. Going by Windsperger's theory, a franchisee would have significantly less ownership rights if he invested in Kengeles. Kengeles' initial franchise fee USD 18,750⁸⁵ which translates to approximately Kshs. 1.3

⁸⁴ Josef Windsperger (2001) "Ownership Rights in Franchising Firms" *Discussion Paper Series in Economics and Management, Paper No. 01-24*, Center of Business Studies, University of Vienna, German Economic Association of Business Administration- GEABA, 2001.

⁸⁵ Kengeles Management Group (2006) "Kengeles Management Group Franchise Brochure" Nairobi. Sourced on 31/04/06.

million. In comparison, the Steers franchisee in Kenya pays \$ 20,000 (approximately Kshs. 1.4 million).⁸⁶ The initial fees demonstrate the individual values of the franchises.

2.5. Review of trade practices in Kenya and the development of franchising in Kenya

In order to understand the potential of franchising in the Kenyan economy, it is necessary to trace in brief the development of the Kenyan economy and franchising within that economy.

The pre-independence history of Kenya's economy can be divided into three phases: pre-colonial subsistence farming, the period of consolidation of the extraction of labour and the penetration of settler farming, and the establishment of indigenous entrepreneurs.⁸⁷ The indigenous entrepreneurs consisting both of white settler farmers and African farmers paved the way for the post independence economy. This is because they influenced the mixed structure format that characterised the Kenyan economy.

Instead of opting for an entirely socialist based economy like her neighbour Tanzania, Kenya opted for an economy that was market based, supportive of the already existing private sector (European settlers and indigenous farmers), and open to foreign investment. In addition, this format incorporated African Socialist values. This was demonstrated in documents such as the Sessional Paper (SP) No. 10 of 1965, "African Socialism and Its Application to Planning in Kenya." In the beginning, the Kenyan economy developed rapidly with bright prospects for the future. However, after some time the Kenyan economy slowed down due to several shocks and setbacks in the late 1960s and 1970s. Setbacks included the oil crises of 1973 and 1979, the decline in the world price of coffee, which was a principal, export of Kenya, among others. The situation was exacerbated further by the collapse of the East African Community and the common currency area linking the three East African

⁸⁶ Wanjiru Waithaka (2007) "Legal obstacles that slow down the growth of franchising in Kenya," *op.cit.*

⁸⁷ UNCTAD (2005) "Voluntary Peer Review on Competition Policy: Kenya" UNCTAD/DITC/CLP/2005/6 at <http://www.unctad.org> last accessed 28/06/07.

countries in 1977.⁸⁸ Kenya had made some key investments in the EAC and its collapse had negative economic impacts. The Structural Adjustment Programs (SAPs) wreaked further havoc on the economy by opening up a market that was not ready to foreign competition.

In the late 1980s, Kenya's general trade policy objectives were articulated in the Sessional paper No. 1 of 1986 on *Economic Management for Renewed Growth*.⁸⁹ This paper articulated the need for a market driven economy. It also touched on the question of Kenya's competition policy. Until then, Kenya did not have any competition policies. The Sessional Paper noted that Kenya did not have any comprehensive policy making restrictive practices illegal and no administrative or legal mechanism to prevent them. In order to address this, The Restrictive Trade Practices, Monopolies and Price Control Act, Chapter 504 of the Laws of Kenya (Cap 504) was enacted in 1988 and came into force on 1st February 1989. In a nutshell, the provisions of the legislation are as follows:

- . Part I - This Part deals with interpretation and establishes the Monopolies and Prices Commission which is the primary enforcement body for competition policy.
- . Part II - This Part contains provisions on restrictive trade practices.
- . Part III - This Part contains provisions relevant to Control of Monopolies and Concentrations of Economic Power.
- . Part IV - This Part has provisions relating to the Control and Display of Prices. It has been of no practical value for many years as Kenya scrapped price controls in 1994.
- . Part V - This Part establishes the Restrictive Trade Practices Tribunal.
- . Part VI - This Part contains miscellaneous provisions.

⁸⁸ UNCTAD (2005) "Voluntary Peer Review on Competition Policy: Kenya" *op.cit.*

⁸⁹ WTO (2007) "TRADE POLICY REVIEW BODY: KENYA Report by the Government - Part V to VII" at <http://www.wto.org/> last accessed 28/06/07.

Of relevance to franchising, is the competition policy governed by Part II of Cap 504. The principal objective of Kenya's Competition Law is to encourage competition in the domestic market by prohibiting restrictive trade practices, controlling monopolies, concentrations of unwarranted economic power and prices. Despite this law, there is a lack of a competition culture in Kenya.⁹⁰

Competition is a fairly new phenomenon in developing countries. As long as there are competing manufacturers, wholesalers, retailers etc., many people will think that there is adequate competition. As a new phenomenon, competition has not been understood well. For example, when the Kenyan law was being debated in Parliament some members of Parliament thought that competition law and policy should be applied to curtail the preponderance in business by a certain group of Kenyans vis-à-vis those deemed to be indigenous. Yet another Member of Parliament felt that competition law should be applied to prohibit the practice of requiring new entrepreneurs to pay goodwill. It is clear that law makers did not understand the law they were promulgating.

Due to a weak competition culture, foreign franchises in the fast food industry are able to operate almost at maximum profitability, as they are almost a monopoly. An example is the Steers and Nandos chains. These are owned by the same South African Greek family.⁹¹ This is clearly a case of a particular enterprise have the majority share of the market. Further, most of the profits that these chains make are repatriated back to their country of origin. Such a monopoly of sorts allows such companies to thrive. An example is the Kenyan Steers chain

⁹⁰ Peter Muchoki Njoroge (2004) "Challenges/obstacles faced by competition authorities in achieving greater economic development through the promotion of competition - the Kenyan experience" 07/01/2004 at <http://www.oecd.org>. last accessed 28/06/07.

⁹¹ Henry Clark Hoggers Limited Kenya, interview on 3/07/07 at Steers Muindi Mbingu. Henry Clark is the C.E.O of Hoggers Limited representing the Steers Franchise. Mr Clark manages the Steers Regional Franchise together with the Steers Regional Franchisee, Mr Nurdin Ajania.

returning to profitability within 2 years after a representative from the parent franchise taking over. In a healthy competitive economy, it would take longer for such an entity to recover, as other more able entities would capture its market share as it declined.⁹²

In the early 1990s Kenya embarked on structural and macroeconomic reform, including in trade, to establish a more growth-conducive economic environment. Kenya's trade policy objectives include moving towards a more open trade regime, strengthening and increasing overseas market access for Kenyan products, especially processed goods, and further integration into the world economy. These policy objectives have been pursued through unilateral liberalization, and regional and bilateral trade negotiations, in particular within the African region, as well as through its participation in the multilateral trading system. Kenya is a member of the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC), the African Union (AU), and the Inter Governmental Authority on Development (IGAD).

Key in encouraging investment was the inception of the Investment Promotion Centre (IPC), a public funded institution, which was established in 1992 as a one-stop shop geared to promote investment in the country. IPC processes all applications for new investments and forwards recommendations to the Ministry of Finance and Planning for approval by the Minister. A General Authority license is issued within one month with prior approval from the relevant authority in charge of issuing the license.⁹³ The Government also undertook key economic reforms with a view to promoting both domestic and foreign investment. These include abolishing export and import licensing, rationalizing and reducing import tariffs,

⁹² Henry Clark interview *op.cit.*

⁹³ WTO (2007) "TRADE POLICY REVIEW BODY: KENYA Report by the Government - Part V to VII," *op.cit.*

liberalization of foreign exchange and price controls and partial liberalization of the capital markets among other measures.

The Foreign Investments Protection Act (FIPA)⁹⁴ was also enacted in order to encourage investment. The Act guarantees repatriation of capital, after tax profits and remittance of dividends and interests accruing from investing in the country. The constitution also provides guarantee against expropriation of private property unless for security or public interest and when this happens fair and prompt compensation is paid.

The Sessional Paper no. 1 of 1994 on Recovery and Sustainable Development was also a fundamental stimulant for economic growth. This Paper emphasized on the increased role of the private sector in economic growth. Judging from the above, economic developments and reforms of the 1990s created a more conducive environment for existing businesses to thrive. However, these developments and reforms were not sufficient to encourage growth of entrepreneurship.

Another avenue to stimulate and encourage growth of entrepreneurship is needed; this is franchising. According to David Maina in his paper "How to Support and Conduct Franchising for Effective Economic Development: The Kenyan Situation,"⁹⁵ the larger share of Kenya's entrepreneur base is emerging and has grown significantly in the last 15 years, hence there exists an under-developed entrepreneur culture. Small and medium enterprises (SMEs) and informal sector micro businesses are not structured nor supported. Further, they do not enjoy the experience they need in order to grow and thrive in a changing and increasingly competitive business environment. A typical franchise package includes a

⁹⁴ Chapter 518 of the Laws of Kenya

⁹⁵ David Maina (2006) "How to Support and Conduct Franchising for Effective Economic Development: The Kenyan Situation," at <http://www.afdb.org/> last accessed 11/07/07.

complete business operation system of tried, tested and proven structures, procedures, standards, systems and strategy. It is the ideal approach to shorten the learning curve significantly for this growing and robust sector. Failure to give this sector structures and develop a strong sustainable entrepreneur culture will lead to an under-developed economy and restricted growth.

This Chapter has examined the law relating to franchising including trade mark laws. From the discussion it can be concluded that the franchise relationship goes beyond IP related laws; trade mark law does not suffice to support franchise relationships. The reason for this is that it addresses a specific aspect of the franchise relationship, i.e. IP related issues in this trade marks. Kenya therefore requires a specific legislation that will encompass the various aspects of law that are intertwined in a franchise relationship as discussed in this Chapter.

Also discussed in this Chapter was the place of franchising in the Kenyan economy. It can be concluded that franchising is a relatively “young” aspect of our economy. Within the right framework, franchising can be a key contributant to economic growth and development, especially where the franchises are avenues of Transfer of Technology (TOT) and are adapted to the circumstances of Kenya.

Chapter Three delves into the legal obligations of parties to a franchise contract and the problems they face.

Chapter 3

Legal Challenges for Franchisors and Franchisees in Kenya

This Chapter explores the legal challenges faced by franchisors and franchisees in Kenya. The discussion in this Chapter draws from Chapter 2, which was a discussion of the concept of franchising. Chapter 2 examined the legalities as a whole of franchise contract; this Chapter goes into the specific legal issues affecting the parties to the franchise contract. The question of TOT through franchising is also discussed.

3.1. Understanding intellectual property rights as a franchisor

The franchisor owns all the IP rights to the products that he authorises the franchisee to trade in. In relation to trade marks, these rights are primarily in relation to the mark or name and the goodwill associated with it. It is imperative that the franchisor's rights are protected in order to maintain the existing goodwill of the product and to prevent the franchisee from abusing the franchisor's rights.

3.1.1. Trade mark law in Kenya and the franchisor

Kenyan law recognises seven classes of intellectual property: trade marks and service marks; patent; utility models; industrial designs; rationalisation models; copyrights; and plant breeders rights.

The main statute governing trade mark law in Kenya is The Trade Marks Act, cap. 506.⁹⁶ In addition to the Act, The Trade Marks Rules,⁹⁷ offer the regulatory framework for the

⁹⁶ No. 51 of 1955, No. 39 of 1956 (revised edition 1962), as amended by the Trade Marks (Amendment) Acts, Nos. 11 of 1965, 1 of 1984, Statute Law No. 7 of 1990 and as last amended 1994.

⁹⁷ L.N. 575/1956, 454/1959 (revised edition 1962), as amended by L.N. Nos. 44 of 1970, 138 of 1971, 131 of 1975, 249 of 1988 and in 1994.

operation of trade mark law in Kenya.⁹⁸ According to Ben Sihanya,⁹⁹ trade marks are registrable in Kenya under two broad categories: those that are distinctive, whereby the mark should not be descriptive of the product that bears it for example the “Golden Arches” in the McDonald’s trade mark. The “Golden Arches” which is the corporate identity of McDonald’s, is very powerful and is instantly recognized worldwide.¹⁰⁰ The “Golden Arches” does not, however, describe the various McDonald’s products; it is distinctive, not descriptive.

The second category of registrable marks in Kenya consists of those that are capable of distinguishing the product, for example the mark “Coca Cola” distinguishes the particular soft drink bearing that name from other soft drinks such as “Fanta,” also produced and distributed by the Coca Cola Company. It is important that a franchisor ensure that his trade mark is registered within the Kenyan jurisdiction if it is not a notorious mark. Notorious marks have automatic protection under both Kenyan and international law.¹⁰¹ Registration of a trade mark that is not notorious ensures that it is protected by law. The trade mark should however fall in one of the two aforementioned categories in order to qualify for registration.

On the international level, Kenya is a member of the World Trade organization and has been a signatory to TRIPs Agreement, since January 1995. Under Article 21 of TRIPs, members are free to determine the conditions on which licences and assignments may be granted. Article 21 further provides that the owner or proprietor of a mark reserves the right to assign

⁹⁸ WIPO (2002) “Kenya (KE) Legislative Profile,” at <http://www.wipo.int>, accessed 11/07/2006.

⁹⁹ Bernard Sihanya (2006) *Intellectual Property Law teaching materials III*, *op.cit.*

¹⁰⁰ John Hawkes (1997) “McDonald’s UK: Balancing the Global Local Demands of the Brand,” *Brand Warriors Corporate Leaders Share Their Winning Strategies* (London) 1997, pp.93-104. John Hawkes was the senior vice president of McDonald’s UK as at the time the article was published.

¹⁰¹ See Chapter 1 §1.4.

the mark with or without the transferring the business to which the mark belongs.¹⁰² In some models of franchising, both the mark and the business system are transferred to the franchisee by the franchisor. This is the reason why there is instant recognition of products when a trade name transferred to a franchisee is mentioned. For example in Kenya, when the trade names Nando's and Steers are mentioned, there is an immediate identification to the fast food industry by the consumers. Though the individual restaurants are independently operated businesses, they show a common identity to the public.

In addition, Kenya is a member of several treaties relevant to trade mark law. These treaties include: The Madrid Agreement (International Registration of Marks) and The Madrid Protocol (International Registration of Marks)¹⁰³ and The Nairobi Treaty (Olympic Symbol).¹⁰⁴ On the African Continent, Kenya has been a member of Member of The African Regional Industrial Property Organisation (ARIPO),¹⁰⁵ and The Harare Protocol on Patents and Industrial Designs within the framework of ARIPO.¹⁰⁶

Having looked at a brief history of Trade Mark law in Kenya, I will now proceed to discuss its relation to franchising. Transactions involving use of trade marks by parties other than the owner involve a form of licensing. In Kenya, licensing of trademarks occurs mostly for pharmaceuticals, household products, and fast food products. Licensing can be advantageous over outright entry into the local market, since it allows foreign firms to harness domestic marketing experience, and it minimises costs. As aforementioned in Chapter 2, for a franchisor, the licence agreement takes the form of the franchise contract.

¹⁰² Bernard Sihanya (2006) *Intellectual Property Law teaching materials V Lecture to LLB IV MODULE II on 18/04/06*, University of Nairobi, Faculty of Law. I was a student in this class and the abovementioned teaching materials used are on file at Innovative Lawyering Nairobi.

¹⁰³ This has been the position since June 1998.

¹⁰⁴ This has been the position since September 1982.

¹⁰⁵ This has been the position since February 1982.

¹⁰⁶ WIPO (2002) "Kenya (KE) Legislative Profile," *op.cit.*

In order to ensure that the franchisor's IP rights are adequately protected, the franchise agreement should specifically address penalties for infringement. These penalties should be brought to the attention of KIPi. Royalties due to the franchisors are taxed at 20% of gross for non-residents; residents pay 5%.¹⁰⁷

In addition to a sound franchise agreement, franchisors will also soon have the aid of the Kenya Franchise Association (KFA) to ensure the smooth running of the franchise. According to the chairman of KFA, Gavin Bell,¹⁰⁸ KFA is developing a system of network registration for legal, ethical issues and a policy for franchise system. This system is to be run by competent legal experts forming the Legal and ethics committee of KFA. The target for the completion of this system is the year 2008.

3.1.2. Obligations of the franchisor and compliance

As aforementioned, there are no standard franchising laws in Kenya. This section contains a description of model franchise law that I propose can be applied to the Kenyan situation.

Franchise agreements contain the obligations of both parties. The written franchise agreement is the most important legal document in a franchise relationship. Like with any other contract, it should be clear what is required of each party. These requirements which include the franchisor's obligations should be set out in clear unambiguous terms. Drawing from the discussion in Chapter 2 on franchising agreements,¹⁰⁹ the following point can be made: As the franchisee and franchisor make their decision on entering into a franchise relationship, a

¹⁰⁷ The Economist Intelligence Unit (2006) "Kenya risk: Legal & regulatory risk" at <http://www.tmcnet.com>. Last accessed 07/07/06

¹⁰⁸ Gavin Bell Kenya Franchise Association, interview on 12/05/06 at Kengeles Lavington at Nairobi, *op.cit.*

¹⁰⁹ See Chapter 2 §2.2.

decision that neither party should take lightly, it is important that they begin this complex and fluid relationship from the same starting point. A meeting of the minds must occur.

Apart from the obligations contained in the franchise agreement, franchisors are also required to provide details about the franchisee, before the two parties can enter into the franchise agreement. This information is contained in what is known as a disclosure document.¹¹⁰ Once a potential franchisee has perused through a disclosure document, he can then make an informed choice as to whether or not to enter into the franchise agreement. All information provided must be accurate in order to prevent any statement in the document from being misleading to a reasonable prospective franchisee.

According to the Australian regulations on franchising posted on the UNIDROIT website,¹¹¹ some of the requirements of the Australian disclosure documents include franchisor details, business experience, existing franchises, performance of the brand to be franchised, intellectual property details, and litigation details among other information. The UNIDROIT Model Franchise Disclosure Law (hereafter the MFDL)¹¹² provides for a more detailed disclosure document. The requirements are set out below.

Article 6, of The MFDL provides that information to be disclosed shall include the legal name, legal form and legal address of the franchisor and the address of the principal place of business of the franchisor. The trade mark, trade name, business name or similar name, under which the franchisor carries on or intends to carry on business in the State in which the

¹¹⁰ UNIDROIT (2006) "*The UNIDROIT Guide To International Franchise Agreements*," *op.cit.*

¹¹¹ UNIDROIT (2006) "*The UNIDROIT Guide To International Franchise Agreements*," *ibid.*

¹¹² UNIDROIT (2006) "*The UNIDROIT Guide To International Franchise Agreements*," *ibid.*

prospective franchisee will operate the franchise business, is the second key element to be provided.

Of importance is information regarding the franchisor's intellectual property to be licensed to the franchisee, in particular trademarks, patents, copyright and software. Details of registration and or the application for registration, if any, as well as the name of the owner of the intellectual property rights should be included. The franchisor is obligated to make known litigation or other legal proceedings, if any, which could have a material effect on the franchisee's legal right, exclusive or nonexclusive, to use the intellectual property under the franchise agreement in the State in which the franchised business is to be operated.¹¹³

Included in this second element is a description of the franchise to be operated by the prospective franchisee. The description should include information on the categories of goods and or services that the franchisee is required to purchase or lease, indicating whether any of these have to be purchased or leased from the franchisor, his affiliates or from a supplier designated by the franchisor.

The potential franchisee should be aware as to whether he has the right to recommend other suppliers for approval by the franchisor. The franchisor should indicate any revenue or other benefit that may be directly or indirectly received by the franchisor or any of the affiliates of the franchisor from any supplier of goods and or services to the franchisee. Such benefits may include rebates, bonuses, or incentives with regard to those goods and or services. It should be indicated whether these shall be passed on to the prospective franchisee or, if not, whether a price mark-up will be made by the franchisor or the supplier recommended by the

¹¹³ UNIDROIT (2006) "*The UNIDROIT Guide To International Franchise Agreements,*" *op.cit.* See also International Franchise Association (2007) "Consumer Guide to Buying a Franchise," at <http://www.franchise.org/> last accessed 04/10/07

franchisor. An example of such provision in action is the system McDonald's uses to source suppliers when they franchise in a new location. John Hawkes in his article "McDonald's UK: Balancing the Global Local Demands of the Brand," states that before McDonald's opens its doors in a new market, it has to invest resources and integrate vertically through the local food industry, in order to make sure that it has the quality supplies needed.¹¹⁴ This means that a potential franchisee will be required to remain with these suppliers pre-selected by McDonald's.

In addition to the description of the franchise, the franchisor should also provide a description of the business experience of the franchisor and its affiliates granting franchises under substantially the same trade name. This should include the length of time during which each has run a business of the, type to be operated by the prospective franchisee; and the length of time during which each has granted franchises for the same type of business as that to be operated by the prospective franchisee. Any information on previous franchisees trading under substantially the same trade name and have ceased to be franchisees during the three fiscal years before the one in which the franchise agreement is to be entered into should be provided as well as an indication as to why those relationships ended.

In line with the previous point, the franchisor should avail information as to the total number of franchisees and company-owned outlets of the franchisor and of affiliates of the franchisor granting franchises under substantially the same trade name. This information should include the names, business addresses and business phone numbers of the franchisees. Of particular importance are franchisees of the franchisor or of any affiliates dealing in the same product near the potential franchisee. At the moment, this particular requirement is not applicable as

¹¹⁴ John Hawkes (1997) "McDonald's UK: Balancing the Global Local Demands of the Brand," *Brand Warriors Corporate Leaders Share Their Winning Strategies*, *op.cit.*

most franchisees operate all the outlets of a particular franchise. A good example of this is the Steers franchise in Kenya whose outlets are managed by one company: Hoggers Limited.¹¹⁵

Another element to be disclosed is the address of the franchisor's principal place of business in the State where the prospective franchisee is located.

In the disclosure of the details of business of the franchisor, the details to be included include the names, business addresses, positions held, and business experience of any person who has senior management responsibilities for the franchisor's business operations in relation to the franchise.

The franchisor is also obligated to disclose the legal history of the business. Details of this disclosure should include any criminal convictions or any finding of liability in a civil action or arbitration involving franchises or other businesses relating to fraud, misrepresentation, or similar acts or practices. These details should cover the franchisor; and any affiliate of the franchisor who is engaged in franchising for the previous five years. In addition information as to whether any such action is pending against the franchisor or its affiliate, and the court should also be provided.¹¹⁶

It is vital that information on any bankruptcy, insolvency or comparable proceeding involving the franchisor and its affiliate for the previous five years and the court citation thereof should be made available to the franchisee by the franchisor. This is especially important so as to enable a franchisee determine whether or not the franchise is a viable venture. Aside from the liquidity the other vital financial matters to be disclosed include an estimate of the

¹¹⁵ Henry Clark interview, *op.cit.*

¹¹⁶ UNIDROIT (2006) "*The UNIDROIT Guide To International Franchise Agreements,*" *op.cit.*

prospective franchisee's total initial investment and financing offered or arranged by the franchisor, if any. The audited or otherwise independently verified financial statements of the franchisor including balance sheets and statements of profit and loss, for the previous three years should be included in the financial disclosure. This applies to franchisors that have been in business for less than three years. Such businesses are required to disclose all financial documents prepared during the duration of the business. All historical or projected financial information provided should have a reasonable basis at the time given and must be as accurate as possible. If the information includes performance of other franchisees, the level of performance of each franchisee must be stated separately.

The franchisor is also obligated to disclose what form of development he intends to propagate through the franchise. This is particularly necessary especially if a country is keen to monitor what kind of franchises are set up within its territory. Some franchises may not be beneficial to a country in any way. According to Dr. Sihanya, the aim of some franchisors is to solely find a market for their products without making any investment in the country. Such franchises are anaemic to the development of the country as they employ the "supermarket model" so to speak i.e. selling their products without adding any value to the economy. An example is when the Steers franchise required its franchisee to import food items available in Kenya.¹¹⁷

The MFDL further provides for obligations of the franchisor to be included the franchise agreement. This information is outlined below and includes the term and conditions of renewal of the franchise. This is very important and the franchisee should insist on this

¹¹⁷ Bernard Sihanya (Dr.) Interview on 3/10/07, *op.cit.*

particular element is set out clearly in order to avoid situations that may lead to him losing the franchise.

The franchisor has an obligation to do an initial and ongoing training for the franchisee. The franchise agreement should have a description of the initial and on-going training programmes. In Kenya, some existing franchises have taken steps to implement this. Examples include the Kengeles franchise and the Steers franchise, both in the fastfood industry. The Kengele's Management Group (KMG) Franchise package brochure¹¹⁸ specifies that KMG will provide a support system. The brochure states that the system will include initial training, on going training, marketing and advertising support as well as resolution of operational challenges among other things.¹¹⁹

The franchisor is further obligated to state the extent of exclusive rights to be granted, including exclusive rights relating to territory and or to customers. Also to be provided is information on any reservation by the franchisor of the right to use, or to license the use of, the trademarks covered by the franchise agreement, as well as the right to sell or distribute the goods and or services authorised for sale by the franchisee. The franchisor must specify whether he will exercise the right directly or indirectly through the same or any other channel of distribution, whether under the trademarks covered by the agreement or any other trademark.

The franchisor is further obligated to state the conditions under which the franchise agreement may be terminated by the franchisor and the effects of such termination. Further,

¹¹⁸ Kengeles Management Group (2006) "Kengeles Management Group Franchise Brochure," *op.cit.*

¹¹⁹ Kengeles Management Group (2006) "Kengeles Management Group Franchise Brochure," *ibid.*

the franchisor is obligated to allow the franchisee to state the conditions under which the franchise agreement may be terminated by the franchisee and the effects of such termination.

The statement of limitations imposed on the franchisee, in relation to territory and or to customers is another one of the franchisor's obligations. Limitations as to in-term and post-term non-compete covenants also fall under the category of limitations.

The initial franchise fee, whether any portion of the fee is refundable, and the terms and conditions under which a refund will be granted are to be stated by the franchisor. Included in this category of obligations are other fees and payments, including any gross-up of royalties imposed by the franchisor in order to offset withholding tax. The KMG Franchise Package brochure provides that a prospective franchisee shall pay an initial franchise fee of Kshs. 1.5 million as well as a management service fee which is 6% of the net revenue. These two fees are just an example of some of the payments that may be required of a franchisee, which a franchisor should disclose.

Additionally, the franchisor is obligated to make known to the franchisee the restrictions or conditions imposed on the franchisee in relation to the goods and or services that the franchisee may sell. The KMG Franchise Package has a clause on restrictions. The franchisee is required to work closely with KMG in development of the product and brand. In order to do this, the franchisee is required to devote their full time to the brand franchise and its operation. The KMG trade marks remain the franchisor's trade mark and the franchisee is required to seek prior approval before use at all times.¹²⁰

¹²⁰ Kengeles Management Group (2006) "Kengeles Management Group Franchise Brochure" *op.cit.*

The franchisee should also be made aware of any conditions for the assignment or other transfer of the franchise.

A sound dispute resolution mechanism should be identified by both parties. The parties should also identify suitable forum selection or choice of law provisions.

Where the franchise is a master franchise, the sub-franchisor must, in addition to the items above, disclose to the prospective sub-franchisee the information on the franchisor that it has received as the main franchisee. Additionally it should inform the prospective sub franchisee of the situation of the sub-franchise agreements in case of termination of the master franchise agreement and of the content of the master franchise agreement.

3.1.3. Reputable franchises; dealing with lack of innovation confidence and copy cat businesses

Most Kenyan entrepreneurs lack innovation confidence. This is due to a number of factors including lack of finances and good support systems. Dr. Sihanya cites difficulties in innovation as including difficulties in obtaining any of the four factors of production, the high risks involved, financial and others; and regulatory problems.¹²¹

This means that most Kenyan business are fashioned in line with existing business that are flourishing. An example is the proliferation of “fish and chips joints” in most of the urban areas. Taking a walk along Nairobi’s Moi Avenue, one is astounded at the number of the “fish and chips joints” located on the street. These establishments are along the Kenyan Kenchic Franchise even though most of them are not part of the Kenchic Franchise. This is

¹²¹ Bernard Sihanya (Dr.) Interview on 3/10/07, *op.cit.*

evidence that most Kenyan entrepreneurs are afraid to try anything other than the traditional tried and tested business methods and go as far as copying existing establishments and their business styles. Going back to the “fish and chips joints,” one will notice that all have more or less the same colour schemes ; mainly reds, blues and whites. The yesteryear’s Kenchics’ quality lingers on in the minds of Kenyan consumers, so the new businesses that used Kenchic colours and business style to start off bank on this goodwill to draw in clientele.¹²²

The problem with the copycat style of business is that the trade mark owners do not get anything out of it. Also more often than not, the copycat business struggles to remain on its feet because the entrepreneur does not fully grasp the methods that the trade mark owner has used to propel his business to success.

A more successful method of starting a new business with the full guidance of a trade mark owner is franchising. According to Gavin Bell¹²³ of KFA and KMG 90% of independently conceived businesses in the restaurant and fast food industry fail in the first 18 months of existence. Failure is characterised by closure or fore closure by banks or re-injection of capital by the owners. Mr. Bell further states that the success rate of businesses operating as franchises is 98%. KMG ensures the success of its franchisees by providing three key items: the product and all IP related to it, the business system and an operating and support system. The franchisee receives the identity of an established brand, i.e. the Kengeles brand; he therefore does not need to go into the process of creating a new brand and establishing goodwill. He is also granted the right to use the Kengeles business system. KMG assists the franchisee to set up an operating system. This system includes obtaining specified furniture, fitting and other apparatus which are part of the Kengeles look. In addition, the franchisee

¹²² Gavin Bell, interview on 12/05/06 at Kengeles Lavington, *op. cit.*

¹²³ Gavin Bell, interview on 12/05/06 at Kengeles Lavington, *ibid.*

receives the standard operating manual of Kengeles Bar and Restaurant. The support system consists of training both before and after the franchise opens up as well as market and advertising support. In addition to all this, KMG does an ongoing monitoring of the market and consumer trends and advises its franchisees accordingly. There is also a rich resource of ideas to improve the brand and business as the franchisees pool and exchange intellectual resources through the franchisor. Based on this example, it can be argued that a reputable franchise is a better method for an entrepreneur to start off a business, as compared to copying existing business models without sound knowledge on how they operate.

3.1.4. Dilution of franchisor's trade mark

Dilution of a trade mark occurs when an established trade mark is used to identify a product in a different line from the product that originally bore the mark. Dilution is a form of infringement against a trade mark. According to David Bainbridge in his book *Intellectual Property*,¹²⁴ under Benelux trade mark law, it has been accepted for some time that a trade mark could be infringed even if the consuming public was not misled as to origin.

According to Nicholas Economides in his article "Trademarks,"¹²⁵ there are two types of dilution. These are "dilution by blurring," and "dilution by tarnishment." Dilution by blurring occurs when a mark is used by a different manufacturer in an unrelated line of business. An example is the Dutch case of *Claeryn/Klarien*.¹²⁶ *Claeryn* was a registered trade mark for a Dutch gin. The defendant called his liquid cleaning agent *Klarien*. Both words were pronounced the same in Dutch. It was held that there was an infringement on the basis of dilution and degradation of the registered mark. Persons drinking *Claeryn* would think of the cleaning agent as they drank, a particularly unpleasant prospect. This was sufficient to find

¹²⁴ David Bainbridge, *Intellectual Property*, *op. cit.*

¹²⁵ Nicholas Economides, 1997, "Trademarks," *op.cit.*

¹²⁶ Case A 74/1, Jur 1975, 472 (Netherlands).

infringement even though there was no risk that consumers would think the two products came from the same or connected companies. In other words, the association conjured up in the minds of the consumers was “non-origin” association.

Dilution by tarnishment occurs when the mark is used by a different seller in unrelated goods that are of lower quality than those of the trade mark holder. This form of dilution is likely to affect franchisors. Using a Kenyan example, one of the trade marks of KMG is the “Kula Korna” mark and slogan “Chakula Tamu Bei Bora.” The “Kula Korna” brand represents the over the counter fast food style of operation as opposed to the “Kengeles” bar and restaurant style.¹²⁷ If a vegetable vendor in Nairobi’s “City Market” was to appropriate the “Kula Korna” mark and use it to advertise his products, this would constitute an infringement by dilution.

Other forms of infringement have been discussed in Chapter 1.¹²⁸

3.1.5. Legal redress in event of infringement

The pre- litigation remedies in relation to trade mark infringement have been discussed in Chapter 1.¹²⁹ These remedies are “Cease and Desist,” “Opposition,” and “Expungement.”

An aggrieved franchisor whose trade mark has been infringed has the option of exploring civil litigation remedies should pre-litigation remedies fail. If the franchisor’s mark is registered, the franchisor may institute a suit for infringement.

¹²⁷ Kengeles Management Group (2006) “Kengeles Management Group Franchise Brochure,” *op.cit.*

¹²⁸ See Chapter 1 §1.4.3.

¹²⁹ See Chapter 1 §1.4.4.

According to David Bainbridge in *Intellectual Property*,¹³⁰ for an infringement to be made out, the person responsible must use a sign in the course of trade, business or profession. In a franchise agreement this may occur where a franchisee continues to use a franchisor's mark after the term of the franchise ends or where a franchise has been terminated. In order to succeed, the trade mark owner has to prove that the trade mark is his. The best form of proof is that of registration. Section 46 of The Trade Marks Act, Cap 506 (as amended), states that the fact that a person is registered as proprietor of the trade mark shall be *prima facie* evidence of the validity of the original registration of a trade mark.

Where the mark is not registered but is recognized based on its goodwill, a franchisor has the option to institute an action for passing off. Passing off is a common law mechanism for protecting goodwill between a business and its customer.

According to Benard Murunga in his presentation paper "In Court Everyday: A Legal Practitioner's Perspective On Litigating Trade marks, Brand Management and Franchising,"¹³¹ Lord Diplock identifies five features that must be present to establish a valid cause of action for passing off. These features were identified in the case of *Erven Warnick v. Townend*.¹³²

The first feature is that a misrepresentation was made. The misrepresentation must be material and capable of causing confusion in the mind of the consumer as well as altering the consumer's perception of the quality of the concerned product.

¹³⁰ David Bainbridge, *Intellectual Property*, *op. cit.*

¹³¹ Benard Murunga, (2006) "In Court Everyday: A Legal Practitioner's Perspective On Litigating Trade marks, Brand Management and Franchising," *op. cit.*

¹³² [1979] AC 731.

Secondly, the misrepresentation must have been made by a trader other than the trade mark owner in the course of trade.

Thirdly, the defendant must have made the misrepresentation to his prospective customers. Fourth, the injury to the goodwill of the trade mark owner must have been foreseeable on the defendant's part; and fifth, there must be actual damage to the goodwill, caused by the defendant's actions. An existing franchisee may damage the franchisor's goodwill by falling below standards stipulated in the franchise agreement. The franchisee can do this by providing inferior products and selling them under the franchisor's mark. This amounts to a form of misrepresentation in terms of quality. In such case, not only can the franchisor institute an action for misrepresentation, he may also sue the franchisee for breach of contract.

In the pursuit of any of the aforementioned courses of action, should a plaintiff fear that the defendant may attempt to destroy material evidence, he has the option of applying to the court for *Anton Piller* orders for the purpose of preserving evidence. These orders allow a plaintiff with a strong *prima facie* or his agents to enter into the premises of the defendant in order to seize and preserve the evidence so as to prevent the course of justice from being averted.

Other remedies available are arbitration and renegotiation of the franchise agreements. Most franchise agreements have mandatory arbitration clauses.¹³³

¹³³ UNIDROIT (2006) "*The UNIDROIT Guide To International Franchise Agreements*," *op.cit.*

3.2. Understanding intellectual property rights as a franchisee

Franchisees usually benefit from coordinated marketing efforts managed by the franchisor. In other words, franchising is really a method of systematically sharing the franchisor's IP to distribute goods or services. A franchisee should never forget that the franchisor owns the IP rights over the various elements of the franchise. The franchisee merely trades under licence from the franchisor using his mark. The franchisee should make sure that the entry fee and royalty payments are made as per the agreement. Once the franchise contract has been signed, the franchisee has the right use the IP licensed to him as per the agreement. This means the franchisee may engage in business activities such as selling and advertising among others as per the franchise agreement.¹³⁴

According to Professor James Otieno-Odek in his presentation article "The Role of Intellectual Property in Franchising Arrangements,"¹³⁵ all the franchisee's rights relative to the franchisor's should be outlined in the disclosure documents provided by the franchisor. These rules should comply with the established national regulation for franchising (Franchising Code of Conduct). The franchisee has the right to renegotiate terms that he feels are inequitable. However, this right is rarely covered in the franchise agreement and often arises in the context of litigation.¹³⁶

¹³⁴ Bernard Sihanya (Dr.) Interview on 3/10/07, *op.cit.*

¹³⁵ Professor James Otieno-Odek (2006) "The Role of Intellectual Property in Franchising Arrangements," Nairobi. Professor James Otieno-Odek is the Managing Director, Kenya Industrial Property Institute (KIPI).

¹³⁶ Bernard Sihanya (Dr.) Interview on 3/10/07, *op.cit.*

3.2.1. Transfer of Technology in Kenya

According to Ben Sihanya, transfer of technology (TOT) was defined under the *Draft Code of Conduct on Transfer of Technology* as the transfer of skills or knowledge regarding the application of equipment or technology, but does not include the mere sale of equipment.¹³⁷

Franchising is one of the avenues through which TOT occurs.

According to the WIPO,¹³⁸ there are several trends related to the use of technology in franchising today. Many franchisors use the internet to communicate with franchise owners and suppliers through secure extranets in order to share critical information, facilitate discussion among the franchise network, post operations manuals and updates, disseminate news about ad campaigns, engage in supply chain management, and gather sales reports automatically and without the need for more labour-intensive data entry. Franchisors also use the internet to advertise their network to customers. Where there is contract mixing, franchisors use the internet to engage in business-to-consumer (B2C) e-commerce, often with the involvement of franchisees.

The second method by which TOT occurs in franchising is the sharing of IP by both parties to the franchise. The franchisor brings in trade secrets and methods while the franchisee brings in the knowledge of the market. The extent of the TOT in the direction of the franchisee is however debatable. I base this statement on the observation that the top fast food franchises in Kenya go to great lengths to protect their IP. It is virtually impossible for an ex-franchisee to employ business methods learnt (after the franchise agreement terminates) without risking liability for revealing trade secrets. During an interview conducted with the

¹³⁷ Bernard Sihanya (2006) *Intellectual Property Law teaching materials III, op.cit.*

¹³⁸ WIPO (2004) "WIPO Intellectual Property Handbook: Policy Law and Use," *op.cit.*

Steers Franchise representative in Kenya, it was evident that the interviewee was reluctant to discuss the issue of TOT, as he skirted around the issue.¹³⁹

Ben Sihanya¹⁴⁰ states that aside from franchising, there are other forms of TOT in Kenya. These include licensing, assignments, foreign direct investment, distributorship, international subcontracting, and joint ventures or strategic alliances.

A license arrangement is a business arrangement where a licensor via an ownership right which may or may not be exclusive such as a patent, a trade mark, a design or a copyright has to exclusive right which prevents others from exploiting the idea, design, name or logo commercially. The license allows the licensee to use make and sell, the product or name for a fee without censure. In a trade mark license, for example, the licensee will be granted full privilege to use the trade mark on goods or services provided that the use is in accordance with agreed signage protocols and quality guidelines. There is usually no training component, product development strategy and limited marketing support.¹⁴¹ The lack of training and management support is what distinguishes licensing from franchising.

Joint ventures or strategic alliances are a form of alliance of two separate companies. The companies agree to act together, typically forming a separate legal entity, for a particular purpose. The exact form of the joint venture, in other words the type of legal entity that it is, depends on the wishes of the parties to the joint venture and on national law. Usually the main aim of these ventures or alliances is the transfer of technology as one of the partners is usually of foreign origin.

¹³⁹ Henry Clark interview, *op.cit.*

¹⁴⁰ Bernard Sihanya (2006) *Intellectual Property Law teaching materials III, op.cit.*

¹⁴¹ PIPERS (2006) "Goodwill" at <http://www.piperpat.com/> last accessed 26/05/06.

In sub-contracting, there is one principal enterprise (the subcontractor) pays one or more supplier(s) to produce a particular component for incorporation by the subcontractor in a finished product, which the subcontractor then sells to final consumers. Ben Sihanya¹⁴² states that most TOT occurs in (international) subcontracting and related licensing transactions.

From the discussion in this Chapter, it can be concluded that the rights and obligations of parties to a franchise are dependant on the franchise contract. This conclusion reiterates the need for a franchise specific legislation to ensure that all parties benefit equitably. It can also be concluded that franchises in which franchisors make an investment in Kenya as opposed to the “supermarket model,” serve as an avenue of TOT. However, the franchise specific legislation should address this issue as well in order to ensure that all franchises in the country are beneficial to Kenya.

The next chapter is the final Chapter and it deals with conclusion and recommendations drawn from Chapters 1-3.

¹⁴² Bernard Sihanya (2006) *Intellectual Property Law teaching materials III, op.cit.*

Chapter 4

Recommendations and Conclusion

This Chapter proposes recommendations to issues discussed in previous Chapters. The recommendations proposed broadly address the issues relating to the strengthening of trade mark law in Kenya, and what can be done to encourage franchising and hence TOT in Kenya. This recommendations draw from the conclusion that for a sustainable franchise industry to exist, a franchise specific legal frame work beyond the current trade mark law is necessary.¹⁴³

4.1. Trade mark rights awareness

According to Dr. Sihanya, there exists in Kenya a general awareness of trade marks in the form of brands, but not of the law that regulates them.¹⁴⁴ In order to facilitate a strong protection regime, for trade marks, the public should be educated on the law governing trade marks. The public should be taught to know and appreciate IP in general, and to understand when it is being infringed in any way. Appropriate strategies include seminars, workshops and effective media such as radio and TV. These strategies should be tailor made to the intellectual capabilities of the public as majority of the public is illiterate, and has almost no access to audio visual media such as TV.¹⁴⁵

Lorraine Ogombe of Innovative Lawyering opines that there is a substantial amount of work to be done in terms of trade mark awareness as trade marks are not perceived as assets because they are often intangible.¹⁴⁶ The Kenyan public needs to be dissuaded of the notion

¹⁴³ See Chapters 1-3.

¹⁴⁴ Bernard Sihanya (Dr.) Interview on 3/10/07, *op.cit.*

¹⁴⁵ Bernard Sihanya (Dr.) "Intellectual property confronts counterfeiting in Africa: protecting innovators and consumers in the cyber society," Chapter 19 in Prof Thomas Wilhelmsson, *et al* (eds.) (2000) *Consumer Law in the Information Society* Kluwer Law International, London; pp. 329-364.

¹⁴⁶ Sourced from an interview with Ms Lorraine Ogombe at Innovative Lawyering offices in 2006. Ms Lorraine Ogombe heads the Intellectual Property Programme of Innovative Lawyering that is concerned with research in copyright, trade mark, merchandising, trade secrets and patents as well as related issues.

that trade marks are not assets and that they are indeed valuable and require protection by the law. Innovative Lawyering (IL), a consultancy and research firm on Intellectual Property (IP) among other areas of law has made various efforts to sensitize the public in the area of IP. This has been done by way of workshops, seminars, various publications as well as lectures to various faculties at the University of Nairobi. IL focuses specifically on Kenya and Africa in a bid to sensitize the African continent to IP law suited to its circumstances as opposed to approaching IP from a western basis.¹⁴⁷ IL has taken steps to establish the linkage between trade marks and franchising. On 8th and 9th March 2006, IL organized The Innovative Lawyering, Trade Mark and Franchising Workshop.¹⁴⁸

Another body promoting IP awareness in Kenya is the Uranga Entity Institute (UEI).¹⁴⁹ UEI is an independent public policy research project based in Nairobi. It promoted the World IP Day with the following activities:

- a press release launching a National Innovation Week;
- an essay competition for secondary school students, on the theme of how innovation and creativity will improve the Kenyan economy, for which prizes were offered;
- a memorandum on the draft national policy on traditional medicine and medicinal plants, presented to the three Ministries of Planning and National Development, Health, and Trade and Industry;
- the launch of a book project on "Intellectual Property and the Information Society;"
- distribution of booklets on intellectual property;
- publication of an article in a business news magazine on trade marks and the fashion industry in Kenya.

¹⁴⁷ Interview with Ms Lorraine Ogombe at Innovative Lawyering offices, *op.cit.*

¹⁴⁸ Interview with Ms Lorraine Ogombe at Innovative Lawyering offices, *ibid.*

¹⁴⁹ WIPO (2007) "World IP Day 2007- Activity Reports," at <http://www.wipo.int/> last accessed 28/06/07.

Trade marks are vital aspect of franchise agreements. In the creation of a strong franchise culture in Kenya, trade mark awareness will be a fundamental contributor towards ensuring that franchisor's rights are protected thus encouraging the establishments of more franchises.

4.1.1. Trade mark law courts and trade mark law enforcement inspectors

Kenya is a member of the World Intellectual Property Organisation (WIPO), the African Regional Industrial Property Organisation (ARIPO) and the World Trade Organisation (WTO). The country is also a signatory to other international intellectual property protocols including the WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPs).

With regard to trade marks, Kenya is party to the following regional and international treaties and agreements: The Nairobi Treaty on the Protection of the Olympic Symbol (1981); Trademark Law Treaty (TLT) (1994); Madrid Agreement Concerning the International Registration of Marks (1891)¹⁵⁰ and the Banjul Protocol for the Registration of Marks. Domestically, the main statute governing trade mark law in Kenya is The Trade Marks Act, Cap. 506.¹⁵¹ In addition to the Act, The Trade Marks Rules,¹⁵² offer the regulatory framework for the operation of trade mark law in Kenya.¹⁵³

The capacity of the judiciary to deal with IP issues is limited. Limitations arise principally from the lack of judicial officers well versed with IP issues. There is a real need to train judicial officers in IP as most of them studied law before IP was part of the Kenyan Law curriculum. In addition, although Kenya's commercial section of the High court at Milimani

¹⁵⁰ Since 26th June 1998.

¹⁵¹ As last amended 1994.

¹⁵² L.N. 575/1956, 454/1959, as amended by L.N. Nos. 44 of 1970, 138 of 1971, 131 of 1975, 249 of 1988 and in 1994.

¹⁵³ WIPO (2002) "Kenya (KE) Legislative Profile," *op.cit.*

is assigned to hear all IP matters,¹⁵⁴ the bench is never permanent as it rotates to other courts. This means that even when the bench manages to gain some IP knowledge, rotation means that the knowledge is not applied.¹⁵⁵

In event of a trade mark dispute, franchisors are often faced with a lengthy litigation process through the court system. It is an open secret that the country's judiciary is weak, overburdened, inefficient, corrupt, highly politicised and extremely slow, with cases taking several years to complete. The weakness of the judicial system seriously undermines efforts to strengthen the rule of law a major handicap for business. Companies can wait up to five years to have a case heard, and implementation of the court's decision is often incomplete.¹⁵⁶

Arbitration is often a more viable option, for settling trade disputes. A study completed in July 2004 by the International Commission of Jurists (a non-governmental organisation based in Switzerland) on strengthening judicial reforms found that the court lacked independence from executive pressure over sensitive matters.¹⁵⁷ This factor could discourage foreign based franchises which are a form of foreign direct investment in Kenya.

4.2. Recommendations in the development of the national franchise system in Kenya

Franchising exists in various forms in Kenya from Distribution Franchises, to Manufacturing Franchises, Service Franchises and Business Format Franchises. In Kenya, only a minority of franchises are local brands, with the most recognisable brands being Uchumi Supermarkets and Kengeles. Majority of the brands are international including those in the fast foods

¹⁵⁴ See Practice notes- Classification of commercial matters made on: Tuesday, November 18th 1997, Note 5 by Cockar CJ as he then was. This information is available at <http://www.kenyalaw.org>.

¹⁵⁵ Bernard Sihanya (2006) *Intellectual Property Law teaching materials III*, *op.cit.*

¹⁵⁶ Gavin Bell, interview on 12/05/06 at Kengeles Lavington, *op. cit.*

¹⁵⁷ The Economist Intelligence Unit (2006) "Kenya risk: Legal & regulatory risk," *op.cit.*

industry. The fast foods industry franchises namely Kengeles, Steers and Nandos use the Business Format Franchise system. According to the Kenya Franchise Association (KFA), Business Format Franchising is probably the most under-represented form of franchising.¹⁵⁸

Franchising was previously not a structured sector and the Kenya Franchise Association seeks to promote franchising in Kenya. As a first step, the Kenya Franchise Association has already been registered with the Registrar of Societies and is now in operation. In order to document and track the businesses involved in franchising, the Kenya Franchise Association is working on putting together a database of those businesses involved in franchising as a base for its membership drive. Such a database will make information more readily available to the association and its members and create cohesion and generate efficiencies in coordination as well as match needs and wants in both services and people factors.

According to David Maina of the Kenya Franchise Association, the development of franchising in Kenya is facing numerous challenges.¹⁵⁹ These challenges are outlined in the paragraphs below with possible solutions.

The biggest challenge to franchising development in Kenya is low awareness and understanding of franchising and its benefits. This low awareness manifests itself not only amongst the populace but also among the policy makers. The proposed solution for this is awareness creation in order to enhance the understanding of franchising. Establishment of a

¹⁵⁸ David Maina (2006) "How to Support and Conduct Franchising for Effective Economic Development: The Kenyan Situation," *op.cit.*

¹⁵⁹ David Maina (2006) "How to Support and Conduct Franchising for Effective Economic Development: The Kenyan Situation," *op.cit.*

strong Kenya Franchise Association is vital in order to achieve this objective. KFA can be strengthened through capacity building and funding for awareness creation campaigns.

With regards to policy making, the Kenyan Government needs to initiate and implement policies encouraging franchising. These policies should include the recognition and support of franchising as a Small and Medium Enterprise development model. The formation of a body that looks to mainstream the Micro, Small & Medium Enterprises (MSME) into the Economic agenda of the country with specific policy and funding objectives would go a long way in helping business development and expansion concepts such as franchising take root in the economy. To supplement the MSME body formation, the creation of a National Franchise Development Committee based in the Ministry of Trade would be vital in the creation of the necessary platform for the future of franchising in Kenya. Members of this committee would be drawn from various private and public sector organizations and institutions that are pro-franchising or actively involved in franchising.

The Government should also participate in information dissemination and support of franchising workshops and seminars. The government can aid KFA's capacity building efforts through entrepreneur training. Focus should be in the following areas:

- Franchising best practices;
- Development of IP;
- Documentation and structure of a franchise system;
- Risk mitigation as a franchisor;
- Critical franchisee support elements; and
- Outsourcing and supplier relations.

The second biggest challenge is the absence of a legal and regulatory framework governing franchising. To complement the formation of KFA, a legal framework is necessary. In line with other international franchise associations, Kenya Franchise Association has completed the formulation of its Code of Ethics a comprehensive and practical guide on how members of the association are to conduct themselves. The Code of Ethics is intended to establish a framework for the implementation of best practices in the franchise relationships of KFA members. However, a law to make the Code of Ethics enforceable is necessary.¹⁶⁰

For franchising to be of benefit in Kenya, a large percentage of the franchises must be of local origin. This way, any profits made can be reinvested in the economy as opposed to being repatriated. Benefits of home grown franchises has been seen in countries like South Africa where franchising has an economic contribution of approximately 12% per annum.¹⁶¹ Future reforms in competition law should clearly set out rules of engagement for franchises, especially those of foreign origin.

Intellectual Property Protection is another major challenge to the development of franchising in Kenya. Several reforms are needed. There are several areas in relation to trade marks. The first includes broadening the definition of a trade mark as defined under Section 2 of Kenya's Trade Marks Act. The definition should go beyond name and description to include one or a combination of marks, signs, signatures, symbols, sounds, shape or smells. Such a definition will cover many of the trade marks manifested in franchising and will go a long way into encouraging franchising. If such provisions had been in place, it would have difficult for

¹⁶⁰ David Maina (2006) "How to Support and Conduct Franchising for Effective Economic Development: The Kenyan Situation," *op.cit.*

¹⁶¹ David Maina (2006) "How to Support and Conduct Franchising for Effective Economic Development: The Kenyan Situation," *ibid.*

Kengeles' getup to be infringed in Kenya.¹⁶² Many of the copycat business imitated everything about Kengeles' getup except its name.

In the area of registration of trade marks, Kenyan law emphasises that each registration be limited to things actually used or dealt with by the owner.¹⁶³ Currently, a trade mark must be in respect of goods or services falling under any of the 34 classes listed in Schedule three of the Act. A wider application including the various manifestations of different trade marks should be put in place. This will enable potential franchisors to register all their trade marks.

Limited access to financial services is another issue hindering franchising in Kenya. The country's financial sector and sub-sectors do not have any products to attract or suit the needs of the franchise sector. Generally what exists is a limited access to finance for both potential franchisors and franchisees that is friendly to the franchising environment. The franchising market space will not grow unless access to finance for franchisees and indigenous franchisors is not only readily available but also friendly and supportive to growth.

4.3. Conclusion

Much has to be done to attract in a structured manner foreign franchisors to Kenya. These foreign franchisors will bring new ideas, concepts and fill product and service gaps in the market and not just replicate and take up the otherwise undersized market spaces of already existing local businesses.

However, the downside of having a majority of foreign-based franchises is that Kenyan resources will be used to build other countries' economies with an unequal flow of benefits

¹⁶² Gavin Bell, interview on 12/05/06 at Kengeles Lavington, *op. cit.*

¹⁶³ See Kenya Trade Marks Act Cap 506, §6

due to the lack of a regulatory framework. An example is the use of the Kenya as a launch pad into other markets by the Kenyan Steers Regional Franchise.¹⁶⁴ Kenyan human resources are being trained and sent to countries in the Middle East and other areas with Kenya receiving negligible benefits.

A sustainable way to grow the franchise fraternity in the country is to encourage the growth of indigenous franchise systems and create more franchise opportunities for more Kenyans based on successful business concepts that have done well in the country as private businesses. This can happen in Kenya as well, given our readily available entrepreneur base and human capital. This can be encouraged by developing franchising expertise for existing and budding entrepreneurs so that they can replicate their business concepts efficiently and effectively. For the sustenance of a vibrant Kenyan franchise fraternity, building more technical capacity in Kenyan franchise consultants is necessary. This can be done through training and exposure internationally. The marriage of franchising expertise to local market knowledge will also be vital.

¹⁶⁴ Henry Clark interview, *op.cit.*