

# JUST HOW EXCLUSIVE AN EXCLUSIVE TERRITORY



“The franchise agreement should be reviewed carefully to see what precisely the franchisor is reserving for itself.”

Many franchisees assume that when they acquire a franchise they will be given an exclusive territory by their franchisor.

Before even delving into the question how exclusive an exclusive territory

really is, franchisees should be aware of the fact that many franchisors simply do not provide for any exclusivity at all. In those instances, franchisors provide for what is sometimes referred to as a “four walls territory,” that is, the territory simply encompassed by the four walls of the franchisee’s retail establishment. When a franchise agreement provides for exclusivity, it is necessary to understand

the exact terms of the franchisee’s territorial rights.

In almost all instances where a territory is provided for at all, franchisors routinely exclude from the territorial grant certain types of competition against the franchisee. A typical clause may include the following exceptions:

- Franchisor may sell or allow others

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to sell products or services in non-traditional locations, including kiosks, mobile units, concessions or “shop in shops” located within mass gathering venues such as sports arenas, airports, theatres, schools, universities, etc.;

- Franchisor may accept orders for products or services through the Internet and deliver such products within the franchisee’s territory;
- Franchisor may sell products or offer services within a franchisee’s territory using alternative channels of distribution;
- Franchisor may accept orders for products or services from company owned stores located outside of the franchisee’s territory and deliver such products or perform such services within franchisee’s territory; and
- Franchisor may sell any products or offer any services through any channels of distribution whatsoever using trademarks and intellectual property not licensed to a Franchisee.

Under the first exception, the franchisor reserves for itself and others the right to establish a competing business selling products in non-traditional locations. Thus, for example, a franchisor may reserve for itself the right to establish a kiosk in a mall, stadium or other venue, when a franchisee has a retail store located in a nearby strip mall or downtown area. The franchisor’s objective is to capture a market that would not otherwise be available to the franchisee,

those people for example, attending a sporting event, and a kiosk can help the franchisor develop brand awareness without cannibalizing a franchisee’s sales. Another possible exception, as noted, would be for sales via the Internet. Here, retail franchisors reserve for themselves the right to sell their goods through their website directly to consumers. These sales channels are often located on a website that also includes store locators, which unlike the sporting event example, can impact franchisees’ sales in a significant way.

Another form of competition that a franchisor reserves for itself might be to distribute its product through retail channels that are not dedicated to the product being sold by the franchise. Thus, an ice-cream franchisor may sell its products to grocery stores, supermarkets and convenience stores. Here again, this may have a direct impact on the franchisee. For example, a franchisee located in the same strip center as a supermarket selling the franchisor’s ice-cream products may be competing for the same customers.

Service franchisors may reserve the right to accept orders and perform services for customers located within a franchisee’s territory. For example, a home improvement franchisor may accept an order (possibly via the Internet or at a company owned store) to install an addition to a customer’s home located within a franchisee’s territory.

A franchisor may also reserve the right to establish a competing system using different trademarks. Thus, a restaurant franchisor could use its know-how to operate a competing chicken chain under distinct trademarks and trade-dress.

In sum, the franchise agreement should be reviewed carefully to see what precisely the franchisor is reserving for itself.

**When a franchisor takes actions that violate the franchise agreement, such as selling franchise locations to competing franchisees who are located in close proximity to each other, it may be possible for the franchisees to take legal action. The franchisee may be able to file a claim for breach of the franchise agreement if there is a provision in the agreement that is intended to prevent encroachment. If there is no such clause, the franchisee may allege breach of the covenant of good faith and fair dealing implied in the franchise agreement.**

The impact of this type of competition, or in the words of a number of lawsuits filed with respect to these issues, is encroachment. Competition may harm the franchisee and may significantly impact its ability to succeed. The key is to understand your rights and obligations.

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