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## Navigating Cross-Border Franchise Regulation in Nigeria- Key Considerations for Franchisors

This article seeks to review the regulation of franchising in Nigeria against the background of increased regulatory enforcement, specifically, the stance of the National Office for Technology Acquisition and Promotion (NOTAP) as well as the proposed franchising bill - the Franchising Bill 2022, passed by the Nigerian Senate on 24 January 2023.

NOTAP has recently ramped up its regulatory control to meet up with the novelties that globalization/liberalization of the world economy have brought and to emphasize its promotional and developmental functions with increased emphasis on focal points of enforcement such as the prioritisation of local content. The increased drive for localisation of skill, material sourcing and production underpins most technology transfer agreements and is an overarching object determining registrability. Irrespective of the type of franchise arrangement undertaken, these requirements would be applicable.

We review these regulatory drivers vis-à-vis the franchisors' aim to optimize opportunity from exploitation of their brand name, know-how, training manuals and goodwill. Franchisors seeking to engage within the Nigerian market will be equipped with rudimentary knowledge of the key considerations as they undertake franchise arrangements in Nigeria.

## The Legal Regime for Franchising in Nigeria

Generally, parties to a franchise agreement have the latitude/independence to agree on commercial terms that would be applicable to their business operations/collaborations as they deem fit, though the franchisor would typically hold the pen on hashing out the terms and conditions under which the franchise would be executed. Notwithstanding the above, in Nigeria, parties are obligated to comply with certain provisions of the law and prerequisites to ensure viability of their collaborations and investments as franchisors and franchisees in Nigeria.

Currently, Nigeria does not have a specific franchise legislation. The National Office for Technology Acquisition and Promotion (“**NOTAP**”) Act<sup>1</sup> and the NOTAP Revised Guidelines for Registration and Monitoring of Technology Transfer Agreements in Nigeria as revised in 2020 (“**The Guidelines**”) along with the general rules of contract govern franchising agreements in Nigeria.

The NOTAP Act empowers the NOTAP to register and monitor the execution, of all agreements for the transfer of foreign technology to Nigerian parties, which are connected to any of the following purposes:

- The right to use trademarks or patented inventions.
- The supply of technical expertise or technical assistance.
- The supply of engineering.
- The supply of machinery and plant; and
- The supply and training of staff, or managerial assistance.

The NOTAP Act in seeking to protect the interests of Nigerian franchisees from undue exploitation from franchisors provides extensive rules on the terms and conditions that could be included in franchise agreements. The aim is to ensure eligibility for registration with NOTAP, only for franchise agreements which genuinely seek to enhance local manufacturing capacity. A franchise for mere supply of goods for instance will not meet the mandatory requirements. By virtue of these provisions, cross-border franchise agreements between a foreign franchisor and a Nigerian franchisee are to be in conformity with prescribed conditions which mandate that:

- Onerous conditions which do not favour the franchisee do not form part of the franchise agreement.
- Payments to which the franchisee is obligated are commensurate with the value that the franchisor is delivering.
- The franchisee acquires the technology in the long term e.g., an agreement which seeks to retain franchise relations for more than 10 years will not be registerable.<sup>2</sup>

Against these fundamental rules, we outline key considerations that franchisors should bear in mind as they take steps to expand their business operations to Nigeria via franchising.

<sup>1</sup> CAP N.62, Laws of the Federation of Nigeria 2004.

<sup>2</sup> Section 6 (2) of the NOTAP Act.

## Local Content

In general, technology agreements should be geared at and state the methods for domestication of know-how, local raw material utilisation and skill acquisition, and franchise agreements are to conform with this standard as well. Businesses that are typically covered, by franchise agreements, include manufacturing (e.g., fast moving consumer goods), management of departmental stores or entertainment enterprises, hotel businesses.

The key elements of such agreements would seek to apportion rights relating to the exploitation of trademarks, brand value as well as know-how. In apportioning these rights, the regulator seeks to ensure that the franchisee is given the opportunity to either acquire the rights or domesticate these rights. Franchisors who are in the retail sector are required to, at the very minimum, source raw materials locally.

Another pre-condition is transfer of capacity for manufacturing locally with the actual production of the goods concerned by the franchisee, in Nigeria. Companies involved in sales of imported finished products only are not eligible to register technology transfer agreements". It is important to note that notwithstanding the above, the NOTAP has the prerogative to register agreements which may deviate from these guidelines where deemed to be for national interest.<sup>3</sup>

## Payment considerations

For the franchisor, the purpose of the franchise is to yield value, and, in most cases, franchisors seek free rein to exploit maximum value from their franchise arrangements. In Nigeria, however, technology transfer (franchise) agreements are to be capped at the payment thresholds outlined below:

1. Initial/basic fee- a lump sum, to be reasonably fixed<sup>4</sup>
2. Franchise/continuing fee- 0.5%-2% of net sales or revenue; and
3. Marketing/advertising fee- 1% of net sales or revenue.

The percentage-based fees can only be charged with respect to net sales of locally manufactured goods.

NOTAP's aim appears to be protection of the franchisee, as there is often perceived unequal bargaining power in cross-border franchise arrangements. However, in light of current economic realities, potential franchisors may consider these price limits restrictive, especially where their franchise arrangements contemplate royalty percentages which are in excess of the NOTAP-imposed limits. Under the NOTAP regime, such franchise agreements may not be eligible for registration, on the basis of non-compliance with the NOTAP price limits.

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<sup>3</sup> Section 2 NOTAP Act

<sup>4</sup> Chapter 2.2.7 of the Guidelines.

In the United States of America, which is one of the world's most heavily regulated jurisdictions for franchising, parties are at liberty to determine the rates of royalties and other fees, as long as the franchisee is provided with sufficient information to enable them to make an informed decision, prior to the execution of the agreement. The USA's Federal Trade Commission's Franchise Rules ("the FTC Rules") mandates franchisors to furnish franchisees with a Franchise Disclosure Document ("FDD") at least 14 (Fourteen) days to the execution of the franchise agreement. The FDD will contain detailed information about matters such as the franchisor's background, management, litigation and bankruptcy history, and fees to be paid by the franchisee.<sup>5</sup> Many other developed franchise markets such as Australia, Italy, the United Kingdom and Mexico also adopt the full disclosure approach, instead of franchise fee ceilings. It is yet to be seen whether these ceilings have resulted in significant progress with the overarching goal of the acquisition of technology. It appears that instead, it has created a system where companies which are unable to register agreements proceed to do so outside the regime of NOTAP supervised contracting which ultimately means that the franchisee may be burdened with the economic vagaries that are associated with procuring foreign exchange to meet its obligations to the franchisor.

It is arguable that the uncapped franchise pricing modality would enable NOTAP achieve its objective of localizing these foreign capacities and increase participation by franchisors over and above the potential returns of the existing pricing modalities. This would only be achievable with adequate monitoring and the setup of economic guardrails which incentivize increased investment while still ensuring minimum accrual thresholds for the franchisee.

## **Fund repatriation**

A critical consideration for the franchisor is the repatriation of fees. In general, foreign investors are guaranteed unconditional transferability of funds from Nigeria through an authorised dealer,<sup>6</sup> in freely convertible currency, of— (a) dividends or profits (net of taxes) attributable to the investment; (b) payments in respect of loan servicing where a foreign loan has been obtained; and (c) the remittance of proceeds (net of all taxes), and other obligations in the event of a sale or liquidation of the enterprise or any interest attributable to the investment. Under the NOTAP regime however, companies whose agreements are not registered are not able to take advantage of this general incentive. This implies that the franchisee would have to independently source foreign exchange outside the official market, usually at a premium and with various associated risks such as volatility and uncertainty of commercial costs undertaken.

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<sup>5</sup> Part 436, Title 16, Federal Trade Commission Franchise Rules, available at <https://www.ecfr.gov/current/title-16/chapter-I/subchapter-D>

<sup>6</sup> The Central Bank of Nigeria's Exchange Control Manual defines an "authorized dealer" as banks licensed under the Banks and Other Financial Institutions Act 1991 as amended and other specialized banks licensed to deal in foreign exchange.

Recent illiquidity arising in the foreign exchange market has resulted in significant difficulty for franchisees who are constrained to meet the subsisting foreign exchange obligations in their agreements, thus raising concerns regarding sustainability of franchises with increasing reticence on the franchisors to make significant investments as concerns around the repatriation of their funds via simple means continue to arise. This again necessitates a review of the expedience of the current regime in delivering value to the Nigerian franchise market.

## **Compliance, Monitoring and Enforcement**

NOTAP is increasingly taking steps to enforce the regulations and with respect to every application it undertakes a technical evaluation, economic evaluation and legal evaluation of the technology transfer agreement.

The technical evaluation seeks to assess and affirm that there is indeed technology being transferred and to form a basis on which the economic evaluation is conducted. Amongst other indices, the technical evaluation also seeks to assess the percentage of Local Value Addition (LVA) i.e. the content of the raw materials, packaging materials, equipment and other inputs utilised as part of the franchise. Where deemed necessary, reference could be made to previously submitted agreements for alignment and uniformity. Accordingly, franchisors would be required to modify the agreements to suit NOTAP's requirements.

It is useful to point out that the economic evaluation may be handled in conjunction with banks to confirm that the pricing of the technology is ideal, represents fair market valuation and reflects the CBN's requirements. Additionally, NOTAP may seek to assess in monetary terms, localisation value in employment/jobs footprint, economic value as well as adherence to fee scales prescribed.

The legal evaluation by the regulator seeks to ensure that the terms of the agreement are compliant with provisions of the law, that the term is restricted to three years and that there are no onerous terms in the contract.

Post registration audits are conducted to confirm compliance. In such circumstances, the applicants may be asked to provide evidence of remittances and receipts.

## **The Implication of Non-Registration With NOTAP**

It is inevitable that some franchise agreements will not meet NOTAP's eligibility thresholds for registration. The NOTAP Act states that without presenting a copy of the registration certificate and the agreement registered by NOTAP, no payment should be made to a party outside Nigeria, in furtherance of a

technology transfer agreement, by or on the authority of the Federal Ministry of Finance, the CBN or any licensed bank in Nigeria.<sup>7</sup>

The Court of Appeal interpreted the effect of non-registration with NOTAP in the case of *Stanbic IBTC Holding Plc v. Financial Reporting Council of Nigeria (FRCN) & Anor (2018) LPELR-46507(CA)*. The case was an appeal against the decision of the Federal High Court, which had held that the Appellant's failure to register their software license agreement with NOTA rendered it null and void. The Court of Appeal held that non-registration would not invalidate a technology transfer agreement but would bar the party in Nigeria from discharging their payment obligations to the party outside Nigeria, through or on the authority of the Federal Ministry of Finance, the CBN or any licensed bank.

The implication for parties to franchise agreements is that the franchisee will not be able to access foreign exchange via the CBN-regulated official market to repatriate to the franchisee, fees payable under the agreement. Without access to the official market, the franchisee would be left with the option of sourcing for foreign exchange from the alternative sources which would typically be at significantly higher exchange rates than those available at the official market.

### **Competition law considerations**

By virtue of the provisions of the Federal Competition and Consumer Protection Act ("**FCCPA**"), clauses in franchising agreements which the Federal Competition and Consumer Protection Commission ("**FCCPC**") considers anti-competitive may be held to be unlawful and void. Where the agreement seeks to maintain minimum resale prices for the goods and services to be supplied,<sup>8</sup> or where the conclusion of the agreement is hinged on a party accepting supplementary obligations which ordinarily have no connection with the subject matter of the agreement, the FCCPC is likely to consider these restrictive to competition.<sup>9</sup> In these circumstances, the FCCPC may serve an order on the parties, explaining the reasons for its decision and mandating them to cease their anti-competition practices. The parties may also face criminal liability, which carries a penalty upon conviction, of up to 10% (Ten percent) of each company's turnover for the preceding year.

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<sup>7</sup> Section 7 of the NOTAP Act.

<sup>8</sup> Section 63 (1) of the FCCPA.

<sup>9</sup> Section 59 (2) (e) of the FCCPA.



## New Horizons Proposed Changes to Franchise Regulation in Nigeria

### The Franchising (Establishment Bill) 2022 (“the 2022 Bill”)<sup>10</sup>

There are two bills currently pending before the legislature for consideration: the Franchising Bill 2019 and Franchising Bill 2022 (“the Bill”). The latter was passed by the Senate on January 24, 2023. The Bills are largely similar, and it is expected that at the point of harmonization with the House of Assembly, the provisions of the Bills will be consolidated. We have relied on the provisions of the latter for our analysis. The pivotal provision in the Bill is the requirement for the mandatory issuance of a disclosure document by parties to a franchise agreement. The disclosure document<sup>11</sup> is to be delivered to the franchisee, at least 14 days before the execution of the agreement or the payment of the franchise fees. The Bill states that the disclosure document should contain all material facts, the prescribed documents, all agreements relating to the franchise which the franchisee is to execute, and other prescribed information and documents which will enable the franchisee make its decisions.

The franchisor is also required to deliver to the franchisee a statement of material changes, if any occur.<sup>12</sup> Additionally, the 2022 Bill requires the registration of the disclosure document with NOTAP.<sup>13</sup> Parties are also required to make provision for an opt-out period of at least 7 (Seven) working days, within which a franchisee can freely terminate the agreement and have all sums paid refunded to them, except for an amount which the franchisor can retain to cover the cost of preparing the agreement. Exceptions are made by the Bill for franchise arrangements between affiliates or officers of franchisors, franchisees who have conducted similar businesses two years before the undertaking sought to be made with the franchisor, transfer of existing franchise arrangements as well as franchises valued at a monetary threshold to be set by NOTAP from time to time.<sup>14</sup>

The Bill retains the oversight of the NOTAP on such matters but has by virtue of these provisions streamlined parties’ contracting terms. It also requires that the franchisees cannot carry on businesses similar to the franchisors, for the duration of the agreement, which should not exceed 5 years.<sup>15</sup> Interestingly, the Bill does not adopt the fee cap modality currently applicable under the NOTAP Act and Guidelines; no specific prescriptions are made in this regard, and it appears that this is intentional to enable parties exercise freedom in this regard. Unregistered franchise agreements may also not be presented to any bank nor the CBN for the purpose of fund requisition and remittance. The Bill

<sup>10</sup> SB 969- sponsored by Senator Mukhail Adetokunbo Abiru.

<sup>11</sup> Section 5 of the 2022 Bill.

<sup>12</sup> Section 6 of the 2022 Bill.

<sup>13</sup> Section 2 (2) of the 2022 Bill.

<sup>14</sup> Section 8 of the 2022 Bill.

<sup>15</sup> Section 12 of the 2022 Bill.

proposes to bring all franchise agreements including those between non-Nigerian franchisors within the scope of the Bill.

Another pivotal inclusion is liability for non-compliance. As the current Guidelines do not address liability, this is a critical development because parties who merely resort to procure foreign exchange outside the unauthorized banking channels without registering their agreements may now become liable for non-compliance where their agreements are not registered. Liability includes monetary fines not less than N1,000,000 as well as imprisonment. This means that the NOTAP will be authorised to proceed against parties who do not register their franchise agreements.

## Conclusion

Franchising remains an emerging area in Nigeria's regulatory landscape. The NOTAP Act and Guidelines which presently regulate franchising in Nigeria, impose restrictions which may deter prospective investors. While the aforementioned Bills are the first step toward a franchise-specific law, the legislature must strike a balance between the protection of franchisees and the interests of foreign investors. For instance, while the push for local content is laudable, the requirements should not be so onerous so as to deter potential franchisors in the long term. Instead of a one size fits all approach to the registration of franchise agreements by NOTAP, taking a hard line on technology transfer, the approach should be one that includes practical considerations to suit different franchise models that have developed over time.