from Dilys Gane
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Our ref
Your ref
Date 15 July 1997

Dear Mr Bigmore,

TRADING SCHEMES (EXCLUSION) REGULATIONS 1997

Following representations made by you and others in the franchise industry we intend to make two amendments to these Regulations.

The first deals with the exclusion of schemes in which one participant in the UK acts as a master franchisee. The second corrects the translation of policy into regulation in relation to the VAT based exclusion.

I attach a copy of the draft Regulations which you may find it helpful to see before our meeting tomorrow. I am also enclosing a short note which sets out the Department's response to the other issues you have raised and which you will also want to discuss tomorrow. .

I am copying this letter and enclosures to Brian Smart (British Franchise Association), Richard Berry (Direct Selling Association), Mike Smyth (Lawrence Graham) who will also be attending the meeting and to Martin Mendelsohn (Eversheds) who is unable to attend but who is sending Suzanne Mercer.

Yours sincerely
Dilys Gane

DILYS GANE

THE TRADING SCHEMES (EXCLUSION) REGULATIONS

Definition of "Trading Scheme"

The Fair Trading Act defines "trading scheme" as including any arrangements made in connection with the carrying on of a business, whether those arrangements are made or recorded wholly or partly in writing or not.

In establishing which arrangements are caught by Part XI, it is necessary to consider who is and who is not a participant in the business i.e. the scheme. We consider participants as including only those who are envisaged by the promoter as forming part of the pyramidal structure of his sales operations. The key test as to who is not a participant is their independence from the business operation of the promoter. Participants in trading schemes are separate businesses in one sense but in another sense they are not independent in that they form part of the structure of the scheme.

Examples of arrangements which the Department considers fall outside of the natural meaning of trading schemes are those where service providers provide services to the promoter in the ordinary course of their own business and not as part of the promoters business, or those customers of the promoter whose business is carried on separately and independently from that of the promoter.

Extension of the definition of single tier scheme to schemes with more than a single promoter or participants at the higher level

The Department has given extensive consideration to the case made for providing an exclusion for single tier schemes with more than a single promoter or participant at the higher level. The Department has no intention of differentiating between franchise operations where the nature of the participants is similar to that of consumers in both cases.

The Department's policy is to limit the coverage of trading schemes controls to the minimum needed for the protection of participants and potential participants whose ability to take commercial risks is similar to that of consumers. It is not the Department's policy to prevent multi level franchising schemes which involve participants operating on a small scale. Our policy is to regulate these activities to ensure they employ minimum standards of good practice in dealings with participants.

The approach we have used to provide a different regime for those who run or set up substantial business operations i.e. those in which the participants should have commercial experience or be aware of the need to take expert advice has been to create an exclusion based on VAT registration. At the level at which businesses do not register for VAT, it is our view that there is no difference between the position of participants in multi level marketing schemes and multi level franchise schemes. Both kinds of participant deserve the same

level of protection afforded by the legislation. We are not therefore considering, as some would have suggested we should, drawing up a separate definition of multi level franchising in order to afford them different treatment.

Problems raised in connection with the VAT based exclusion

A number of difficulties in meeting the criteria for this exclusion have been raised.

The Department considers that those involved in operations which do not meet the criteria of the other exclusions and who wish to benefit from this exclusion must consider for themselves how best they can meet and maintain the requirements. Where this may involve costs, businesses must balance this against the requirements of the Trading schemes controls.

In relation to claims that VAT registration will cause delays in business operations, the Department has had extensive consultations with HMC&E who have confirmed that the registration process takes on average 4 days from return of a (properly completed and supported) application form. Applications may be submitted in advance of trading provided that evidence of intent to trade is provided.