



Leisure Update

SUMMER EDITION

By common consent, Brexit is the most important decision this country has taken in a generation and will have a seismic impact on all aspects of UK society. We are already seeing this at a political level. The economic impacts may take longer to manifest themselves but they too will surely be massive and wide-ranging.

Understandably, businesses want to understand what it all means for them. Some businesses in the sector could suffer significantly from a reduction in EU migrant labour – and we bring you an article on this subject in this edition. Others may find trading conditions tougher as a result of increased production costs and a fall in consumer confidence. But some may benefit from a weaker pound.

The reality though is that nobody yet really knows where we will be in two years' time. Four Brexit outcomes are typically mooted:-

- Adopting the Norwegian model and becoming a member of the EEA.
- Negotiating a more tailored model along similar lines to Switzerland with specific trade agreements giving the UK access to the single market.
- Becoming a “third country” like the US and Canada and negotiating a free trade agreement with the EU, which covers goods and (hopefully) services.
- No deal is reached and the UK falls back on WTO Rules.

These options all mask a myriad of constitutional issues and complexities and none presents a fully workable solution. It is possible that the final

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deal does not closely resemble any of these models. Equally, we could end up with a hybrid of different solutions for different industries.

Just one example of the uncertainty and confusion that all of this is creating came to light this week with the news that some businesses in the leisure sector are already telling customers that they no longer need to comply with the allergen labelling requirements of the EU's Food Information for Consumers Regulation. This is not true. Until we formally leave the EU, its regulations continue to have direct legal effect in the UK ("regulations" in this context are different from "directives", which need to be incorporated into the laws of member states via national legislation). Failing to comply with EU regulations is therefore unlawful. It remains to be seen what will happen to this body of law once the UK leaves the EU, but there is a reasonable prospect that the UK will pass legislation to retain these laws. This is just one of the many things that will need to be decided in the months and years ahead.

In what some will see as a welcome relief from Brexit, we also bring you articles in this edition on the new investors' relief and the second in our two-part series on franchising, this time focusing on key considerations and do's and don'ts from a franchisee's perspective.

I hope you find it useful.



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Brexit: What now for EU nationals?

Prior to her swift elevation to Prime Minister, Theresa May came under criticism from fellow Conservative MPs for refusing to guarantee the rights of EU nationals living and working in the UK. The issue is of great concern to the vast numbers of EU nationals working in the leisure and hospitality industry in the UK - recent reports have suggested that as much as a quarter of the UK's hospitality workforce are migrant workers and 45% of these are EU nationals. It is also a great concern for employers across the sector.

While there is no indication that the rights of EU nationals will be affected in the short-term, the longer-term picture remains unclear. So, what can employers in the sector be doing now?

EU audit: Many employers are conducting an audit of the number of EU nationals currently working for the organisation, and the parts of the business in which they are working, to help identify the scale of the issue should the rights of EU citizens be altered in the future. Such an audit will be helpful for future resourcing and budgeting.

Providing reassurance: Some employers are sending all-staff communications offering reassurance, while others are having individual conversations with affected staff. Employers must be careful not to offer any guarantees, when so much remains uncertain, but there is scope for some reassurance that nothing is changing in the short-term and that support would be provided if things did change in the longer-term. Employers may wish to consider what that support might look like.



Providing information: Employers may wish to keep track of Brexit-related news and provide periodic updates to staff. Employers may also wish to encourage EU nationals working for them to consider applying for proof of their residency rights. EU nationals can currently apply to the Home Office for proof of their right to live and

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work in the UK, including permanent residency rights for those who have lived in the UK for at least five years. While such proof is currently unnecessary for most EU nationals, it may provide helpful evidence in future if the immigration rules do change. Those who have obtained proof of their permanent residency rights may also be eligible to apply for British citizenship, which would provide security.

The position of EU nationals in the UK may not be clear until negotiations on Britain's exit from the

EU have been resolved, which could be some time away. Many employers will therefore want to take steps to calm nervousness in the meantime.

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Investors' relief

A new relief was introduced in the 2016 Budget to incentivise individuals investing in shares in unlisted trading companies. The new relief is similar to entrepreneurs' relief and applies to shares acquired on or after 17 March 2016 and could present interesting opportunities for leisure sector investors.

Investors who benefit from this relief would be subject to capital gains tax at 10 per cent on any qualifying gains subject to a lifetime cap of £10 million.

The basic conditions for the relief are as follows:

- the investor must acquire shares in an unlisted trading company
- the shares must be newly issued shares fully paid up in cash by the investor
- the shares must be held for a period of three years (or three years from 5 April 2016, whichever is later)
- the investor must not (other than in certain limited circumstances described

further below) be an employee or officer of the company.

The relief is intended to extend and complement entrepreneurs' relief by creating a strong enterprise and investment culture and enabling companies to raise the capital they need. Unlike entrepreneurs' relief, this new relief is targeted at individual investors, such as business angels, otherwise unconnected with the investee company.

Other differences from entrepreneurs' relief include

- no minimum percentage holding requirement (compared with the 5 per cent requirement for entrepreneurs' relief)
- the shares must be held for a period of three years (compared to 12 months for entrepreneurs' relief)
- shares must be freshly issued to that investor and cannot be acquired by way of transfer.

Furthermore, in the initial draft of the new provisions it was not possible for an investor to qualify for relief if he or she was an employee or officer of the company. This requirement has recently been relaxed to enable 'unremunerated directors' and investors who do not become employees within 180 days of the date on which they acquired their shares to qualify.

The concept of an 'unremunerated director' is similar to, although slightly stricter than, the 'business angel' exception, which enables certain directors to qualify for enterprise investment scheme (EIS) relief. A person will qualify as an 'unremunerated director' provided that he or she was not previously connected with the issuing company or involved in carrying on the trade of the issuing company and, broadly, does not receive any remuneration for being a director (other than some limited exceptions for reasonable returns on investments and reasonable payments for services provided in the course of a trade or profession).

The 'unremunerated director' concept is not the only element of the new investors' relief that is borrowed from EIS. The shares must be newly issued shares subscribed for cash and the relief can be withdrawn if value is returned to investors

within the period commencing one year prior to the date on which the investor acquires the shares and ending at the end of the three year holding period. This ties in with the stated intention of the relief of attracting investors to unlisted trading companies and prevents value being stripped out of the company during the life of the investment.

However, at least in one aspect, the scope of investors' relief is much broader than EIS. While there is a requirement for the investee company to be a trading company (or holding company of a trading group), there is no restriction on the type of trade that may be carried on. So for example, investors in companies with trades such as running hotels, which is an excluded activity for EIS purposes, could qualify for the relief. Furthermore, there is no limit on the size of the company that can qualify for investors' relief unlike EIS, which is subject to balance sheet and employee number caps.

Although billed as an extension to entrepreneurs' relief, investors' relief is really more of a hybrid between EIS and entrepreneurs' relief designed to attract investors to unlisted trading companies without some of the strict requirements of EIS.

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Franchisees: Key considerations and dos and don'ts

In this second instalment of a two-part series dedicated to franchising, we summarise some of the key legal and commercial considerations and "dos and don'ts" from the perspective of franchisees operating in the leisure sector.

Key Considerations

1. Preliminary issues

- You should review the franchisor's operating manual and brand guidelines carefully.
- For overseas franchises, take advice on relevant local laws and jurisdictional issues.
- Ensure that you have sufficient access to working capital to pay fees and meet your obligations.

2. Franchise agreement

- **Rights granted:** ensure that the rights being granted to you are as you expect and include the necessary intellectual property rights. Check the format (e.g. physical outlets, internet etc.), territory, exclusivity and other key elements.
- **Fees:** agree the fee structure (e.g. fixed fees, turnover/profit-based fees or a combination of

the two). Profit-based fees are generally preferable from a franchisee's perspective.

- **Term:** fixed or rolling? If the franchise is a bricks and mortar enterprise, ensure that the term of the franchise agreement is consistent with the term of any underlying lease of the premises to be used for the franchise operation.
- **Return on investment:** make sure the term of the franchise agreement is long enough to allow you to recoup your capital investment and drive profit. Consider whether you need the right to terminate in the event of poor results or if the business becomes unprofitable.
- **Renewal:** ensure (if possible) that renewal is at your option and seek to keep any renewal conditions (including payment of a renewal fee) to a minimum.
- **Termination:** in addition to the usual termination rights for material breach and insolvency, will either party/both parties have the right to terminate on notice? Seek to keep the franchisor's termination rights to a minimum. For bricks and mortar franchises, will you need to terminate in respect of a particular unit if the underlying lease is terminated?
- **Supply chain:** can you use your own supply chain? If you are required to use the franchisor's suppliers, consider pricing implications and contract terms with these

suppliers. There may be limited scope for negotiation.

- **Key obligations on franchisor:** to the extent necessary, make sure the franchisor is obliged to provide advice on how to set up and operate the franchise, provide equipment, products, services, marketing materials and initial training and assist in a public relations launch and advertising.
- **Insurance:** does the franchisor require you to take out specified insurance (e.g. employer's liability, public liability)? Ensure that the cost implications are considered.
- **Indemnities:** ensure that the franchisor indemnifies you for any claims made by third parties that the use of the franchise brand, in accordance with the franchise agreement, infringes the IP rights of a third party.
- **Transfer:** consider in what circumstances/to whom you should have the right to transfer the assets and business of the franchise.
- **Real estate:** for bricks and mortar franchises, ensure that the terms of any underlying lease allow you to modify the premises in accordance with the requirements of the franchise business and consider any future dilapidations liabilities.

Key dos and don'ts

DO

- Think long-term: how long will you need to recover your capital investment and grow the franchise business? If necessary, ensure that you have rights to renew/extend the franchise agreement.
- Ensure that you will have access to sufficient working capital to meet your obligations.

- If you can, speak to existing franchisees to understand the strengths and weaknesses of the business model. Ensure that the franchisor's obligations are clearly set out.
- Ensure that you can obtain fair value for the franchise business on expiry of the franchise term or transfer of the business/assets to another franchisee or back to the franchisor.

DON'T

- Sign an agreement without a clear understanding of what fees will be payable and how this will impact on your profits. If possible, agree profit-based fees, rather than fixed or turnover-based fees to ensure the franchise fee takes account of increases in your cost base.
- Assume that the franchise agreement is non-negotiable. Even for leading brands, there will often be scope for improving the terms, particularly for those that are being launched in a new territory and/or market for the first time.

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Leisure deals update

Over the past few months, we have worked with clients on a number of key deals in the leisure sector. Our most recent highlights include representing:

- **Silicon Valley Bank** on the financing of the acquisition of Guestline (a leading provider of mission critical software for the hospitality sector) by private equity firm the Riverside Company.



- Luxembourg-based **H&F Wings Lux 1 S.à r.l** on the disposal of the remainder of its stake in Hostelworld Group plc, the world's leading hostel-focused online booking platform.
- Longstanding client **Phoenix Equity Partners** on their investment in The Travel Chapter Group alongside the Morris family, the Travel Chapter's founder owners.
- The management team of the **Liberation Group Limited**, the Channel Islands' market-

leading pub, restaurant and drinks business, on its acquisition by Caledonia Investments plc, a transaction which values Liberation at circa £118m.



- **Caffè Nero Group** on its acquisition of Harris & Hoole from Tesco