

Canadian Franchise Review

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FRANCHISE CONSULTING LAW



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The U.S. Invasion: A Look at Some U.S. Franchisors Coming to Canada

Introduction

The last time the U.S. invaded Canada was close to 200 years ago during the War of 1812. Since that time, notwithstanding occasional minor political spats between Canada and the U.S., relations between the two countries have been anything but hostile. The U.S. is Canada's largest trade partner and the two countries currently share the longest demilitarized border in the World. When Americans "invade" Canada today, therefore, they do so by widely distributing their products and services throughout Canada.

The Canadian franchising landscape is representative of this phenomenon. Several U.S. franchise systems continue to dominate the quick service restaurant and other retail sectors, while other American franchisors distribute their popular products and services through Canadian-based franchises. Consequently, Canadians are very familiar with such brands as McDonalds[®], Midas Auto[®] and Sylvan Learning Centers[®], just to name a few.

Other U.S. franchise systems are on the cusp of entering Canada. They vary from quick service restaurants, full serve restaurants and franchise systems offering various kinds of products and services. This article examines some of those U.S. systems, including, Papa John's[®], Two Men And A Truck[®], Pudgie's Famous Chicken[®], Arthur Treacher's Fish & Chips[®], Wall Street Deli[®] and Burritoville[®]. In addition, this article will examine some of the issues these systems face as they attempt to penetrate the Canadian marketplace.

Papa John's

As the third largest U.S. pizza chain (with close to 3,000 units, 22 commissaries and a presence in 14 countries outside of the U.S.), Papa John's phenomenal growth since its inception in 1984 can be attributed to its emphasis on quality and on concentrating on their

core product offering, *i.e.*, pizza. A visit to their seven-acre (\$45 million U.S.) “Papa John’s Corporate Campus” in Louisville, Kentucky will easily persuade the casual observer that Papa John’s is committed to sourcing the best quality ingredients and providing its customers with a superior-quality pizza. Their consumers seem to agree as they paid this NASDAQ-traded company approximately a billion dollars of revenue this past year. This franchisor also boasts that the quality service, training and support provided to their franchisees are among the best in the industry.

Papa John’s currently has seven franchisee-owned restaurants in Alberta (six in Calgary and one in Edmonton) and is about to sign franchise agreements for restaurants to be situated in the Provinces of Manitoba and Saskatchewan. John Campbell, Vice President, New Business Development, is currently leading Papa John’s efforts to locate franchisees for the Province of Ontario. “Ontario represents a huge opportunity for Papa John’s to gain a significant foothold in Canada’s most populous province”, Campbell says with great enthusiasm, something that is obviously not lacking anywhere at the Papa John’s head office.

This pizza giant is specifically looking for franchisees with quality and speed for restaurant success (“QSR”) operational experience, sufficient capital and a strong commitment to make the system flourish in Ontario. Tina Toole, Director, New Business Development confirms this approach: “we are actively seeking franchisees who have the financial depth and management and franchising skills necessary to represent one of the leading U.S. brands and to assist us to quickly expand throughout Ontario”. Toole further emphasizes that “it is critical that there be an absolutely tight fit between us and the prospective franchisees in order to ensure that our entry into Ontario is successful and that our franchisees meet our high, yet realistic goals and expectations”.

TruFoods Corp.

Other systems such as Pudgie’s Famous Chickens, Arthur Treacher’s Fish & Chips, Wall Street Deli and Burritoville are also seeking to expand into Canada, says Jeff Bernstein, President and CEO of TruFoods Corp, the Lake Success, New York-based firm that manages all of these brands. TruFoods concentrates its efforts on acquiring, rebuilding and repositioning under-

performing concepts in the quick serve fast food and fast casual categories. It now wishes to pursue growth from the U.S. where it is based, to Canada.¹

“We recognize the economic viability of our neighbours to the North and are anxious to recapture the brand awareness once held by Arthur Treacher’s Fish & Chips and to expand our other concepts there, as well” says Bernstein. “The Canadian market largely represents uncharted territory for TruFoods and we seek well qualified franchisees/area developers to work closely with us in our efforts to expand into the important markets located throughout Canada”.

TruFoods however faces similar challenges as other U.S. franchisors as each of them seeks to secure local Canadian master franchisees, area developers or franchisees with the appropriate qualifications. Placing traditional advertisements, attending trade shows, hiring franchise brokers and other common recruitment strategies are often found to be insufficient in locating the right candidate. As a result, U.S. franchisors have resorted to more targeted marketing strategies to locate and solicit qualified Canadian investors and managers by, for example, inculcating relationships with entrepreneurs and former and even existing master franchisees and area developers of other systems. By doing so, they hope to develop a wider pool of qualified investors.

Two Men And A Truck

Two Men And A Truck (“TMT”), based in Lansing, Michigan, started as an after-school endeavour for two high school boys, but has now grown to be the largest local residential and commercial moving franchise system in the United States. TMT provides care in the handling and transportation of its customers’ personal and business possessions and offers a full-range of residential and commercial moving services. TMT is now looking to sell the master franchise rights to all of Canada.

John Rogers, Chair of the Franchise and Distribution Group at Davis & Company, is the Canadian lawyer representing TMT. Rogers says that finding someone who can act as master franchisee for such an expansive country as Canada is not a simple task, but that “TMT provides a necessary service in such a high quality fashion, with excellent training and support, that it is proving to be attractive to Canadian entrepreneurs. I

have spoken to one serious candidate who was very impressed with the home office operations in Lansing”, says Rogers, who has visited there himself.

Issues When Expanding into Canada

Not all U.S. franchisors, however, expand to Canada by way of a grant of master franchise rights to all of Canada or a certain territory within it. Some U.S. franchisors seeking entry to Canada do so by granting area developer rights or by direct franchising. In such circumstances, the financial wherewithal is less of a concern as less capital is required to purchase the area development rights or unit franchises. Still, U.S. franchisors have found that it is not always an easy task to find the right “partner” for their requirements.

Other issues which confront U.S. franchisors when entering Canada include being able to source their product and equipment within Canada to reduce transportation costs and avoid tariff or quota restrictions. U.S. franchisors must incur professional fees in order to “Canadianize” their legal documents (i.e., by “converting” their Uniform Franchise Offering Circulars (“UFOC”) into disclosure documents for use in Ontario and Alberta and tailoring their franchise agreements) and to ensure that their disclosure documents and franchise agreements comply with Canadian federal, provincial and local laws.

“These fees and issues must be factored into the franchisor’s cost of entry; otherwise U.S. franchisors will have a rude awakening”, says franchise consultant John Hagood of Franchise Consultants, Inc., an Orlando, Florida franchising consulting firm that specializes in developing and promoting both start-up and mature franchise systems. According to Hagood, “it is imperative that we work with professional advisors familiar with the targeted foreign jurisdiction, or otherwise, our clients’ entry into Canada could become a legal and business quagmire. We avoid these pitfalls by retaining qualified attorneys and accountants who are well versed not only in technical aspects of their respective legal, tax and accounting fields, but also

intimately qualified to work with demanding U.S. franchisors who are anxious to expand their systems into Canada”.

Finally, prior to expanding their systems into Canada, U.S. franchisors must conduct sufficient market research on the Canadian marketplace to determine the demand for the product or service and to identify the level of competition; make changes to ingredients and product specifications to address different preferences of Canadian palettes; confirm that the trade-marks for their franchise systems are available for use in Canada; review their operations manuals and marketing materials; and make other changes to their respective systems to adapt to the Canadian marketplace.

Conclusion

U.S. franchisors have sought, and continue to seek, new markets for their goods and services and Canada is often the most logical destination for their expansion plans. Papa John’s is more than cognizant of this fact as it prepares to enter the world’s most popular destination for U.S. franchise systems outside of Great Britain and Australia. John Schnatter, the 42-year-old Founder and CEO of Papa John’s, recalls fondly that his father, while only modestly successful in business, “was tenacious and had the guts never to quit”. “Never quitting builds character”, Schnatter says. Papa John’s and various other U.S. franchisors will certainly not quit in their search for qualified franchisees, area developers and master franchisees to help them spread their well-sought out products and services throughout Canada. Canadians are bound to see more American “invaders” in the decades to come. Given their insatiable appetite for American goods and services, Canadians are unlikely to resist the trend, especially when good quality, pricing and services are being offered.

¹ TruFoods also recently offered US \$54 million for the financially sagging cafeteria-style eateries of Piccadilly Cafeterias, Inc., based in Baton Rouge, Louisiana. The successful purchase by Trufoods of this chain of restaurants would add 145 restaurants to Trufood’s portfolio.