ONTARIO BAR ASSOCIATION

4th ANNUAL FRANCHISE LAW CONFERENCE

"FRANCHISING LAW 101 – THE BEGINNERS' COURSE"

Thursday, October 28, 2004

Ontario Bar Association Conference Centre
Toronto, Ontario

THE FUNDAMENTAL ASPECTS OF

THE FRANCHISE AGREEMENT

BY: JOSEPH Y. ADLER
Hoffer Adler LLP
250 Dundas St. W., Suite 301
Toronto, ON
M5T 2Z5

Telephone: 416-977-3444
Fax: 416-977-3332
Email: jadler@hofferadler.com

ANDRAYA FRITH
Osler, Hoskin & Harcourt LLP
1 First Canadian Place, Suite 6600
P.O. Box 50
Toronto, ON M5X 1B2

Telephone: 416- 862-4718
Fax: 416-862-6666
Email: afrith@osler.com

THE FUNDAMENTAL ASPECTS OF THE FRANCHISE AGREEMENT

By Andraya Frith, Osler, Hoskin & Harcourt LLP and

Joseph Adler, Hoffer Adler LLP

Franchise agreements are deceptively simple commercial documents. While most do not contain unduly complicated provisions per se, there are several traps for the unwary. No doubt a franchise agreement is very much like other commercial documents, though there are certain aspects of a franchise agreement which are peculiar to it or which otherwise deserve special attention. This paper is our attempt to highlight some of those key contractual terms and to pose various ways to address the issues raised when drafting some of these provisions.

Before we do so, however, it is important to set the context for our analysis of theses provisions. To draft a franchise agreement requires more than simple drafting expertise and a good understanding of the franchisor's existing business operations and objectives. Lawyers and their clients when drafting franchise agreements are confronted by an almost impossible task. They must anticipate specific business and legal issues that might one day in the future arise, which issues have not yet been contemplated at the time that the agreements are drafted.

The problem of anticipating change in contractual matters is not unique to franchise law as it is clearly pervasive in every other area of the law. Yet, it is exacerbated by the fact that the length of many franchise agreements is much longer than in most other commercial agreements. Some franchise agreements are 10, 15 or 25 years or more in duration, so anticipating every possible change and scenario when originally drafting such agreements is virtually impossible. Yet, the success of the system to some extent depends upon a franchisor's ability to address such possible changes in the franchise documentation.

At the same time, the *Arthur Wishart Act (Franchise Disclosure), 2000* (Ontario) (the "Act") requires that the information disclosed by a disclosure document provided by franchisors to prospective franchisees be accurately, clearly and *concisely* set out [Emphasis added]. A major component of the disclosure document, of course, is the franchise agreement and all other related documentation to be signed by the prospective franchisee. Arguably, such agreements and other documentation therefore should be similarly drafted in an accurate, clear and concise manner. The challenge is to draft the agreement as broadly as possible and to anticipate changes over the life of the agreement, while at the same time adhering to the "accurate, clear and concise" obligation under the Act.

Furthermore, franchise counsel are increasingly being asked by their clients to draft their franchise documentation in as plain language as possible and to reduce the amount of legalese present in the documentation. Franchisors not only want to be legally protected from their franchisees, suppliers and other third parties, but they also desire user-friendly franchise agreements that may be used as marketing tools themselves and that do not unnecessarily confuse or intimidate their prospective franchisees. Traditionally lengthy franchise agreements may not therefore satisfy the requirements of the Act nor will it meet the requirements of more demanding franchisors.

To provide franchisors with a measure of flexibility, therefore, franchisors have relied upon the operations manual and policy statements for the issuance of standards and policies affecting the franchise system. This is legally accomplished by the incorporation of the operations manual by reference into the franchise agreement and by general distribution of such policies. Please see below for a further discussion of this practice.

The Act and the disclosure requirements arising out of the Act have considerably altered the franchising landscape in this Province. Since the advent of the Act, franchisors must be mindful when drafting their franchise agreements of the statutory duty of fair dealing (which does not seem to differ much from the common law duty of good faith and fair dealing), the right of franchisees to form or join franchisee organizations and the new disclosure obligations imposed by the Act and the Regulations to the Act. For example, franchisors may no longer interfere, prohibit or restrict, by contract or otherwise, a franchisee from forming or joining a franchisee organization or otherwise prevent them from associating from other franchisees. Any such prohibition or restriction in the franchise agreement will be rendered void and ineffective by virtue of Section 10 of the Act.

Finally, the popularity of the Internet and e-commerce, has presented a whole host of issues that franchisors must address in their documentation, from protecting trade secrets and other intellectual property on the Internet, to domain name and website control and protection, to website terms of use and online privacy issues. Once again, the franchise agreement should be amended to specifically address these very important issues.

In addition to considering the Act, there are several sometimes competing and overlapping objectives that also require attention when drafting franchise agreements. The most important objective in drafting a sound franchise agreement is to "bullet-proof" your franchisor client. One does so by clearly setting out the applicable legal rights, obligations and remedies of the franchisor, franchisee and guarantors, if any. For example, franchise agreements will inevitably deal with the sale, transfer and termination of franchises, and establish the payment obligations of the franchisees and the manner by which the franchisee is to conduct its business operations. Protecting the value of the brand, trade-marks, trade secrets and confidential and proprietary

information is another objective which deserves serious attention by franchisors and their counsel.

Franchise counsel must now also take steps to ensure consistency between the terms and conditions of the franchise agreement (and other agreements) and the disclosure document when preparing the franchise documentation. Internal inconsistencies between the franchise agreement, for example, and the disclosure document not only reflect poorly upon the franchisor, but also expose the franchisor to a possible claim of misrepresentation under the Act or under the common law.

Finally, it is important to consider the following objectives when drafting the franchise agreement:

(a) The process of drafting the franchise agreement should help to solidify the franchisor's understanding of its own system and confirm that understanding with both prospective and existing franchisees. In other words, counsel should ensure that the franchise agreement accurately reflects the way the system is operated in reality.

(b) Ensuring that the agreement does not contain provisions that are unduly abusive, unconscionable or otherwise unfair. Such provisions dissuade prospective franchisees from purchasing the franchise or cause franchisees and their counsel to request amendments to the agreement, thereby increasing the cost of selling the franchise. Furthermore, such onerous provisions could possibly generate dissension amongst existing franchisees and the franchisor and are more likely to be rendered unenforceable by an arbitrator or a court, for example.

(c) Adopting a more collaborative approach to relations as between franchisor and franchisee and otherwise minimizing disputes with franchisees. For example, franchisors might consider including language that would institutionalize the creation of a franchisee association or advisory council to better co-ordinate their

affairs with their franchisees and to encourage franchisees to participate in the growth and the development of the franchise system.

(d) Addressing issues surrounding franchise growth and development and the duration in years of the franchise agreement. For example, will the franchisee be offered a right of first refusal over any of the surrounding territories should they later become available? Is the franchisee granted a right of renewal to extend the term of the agreement and if so, what conditions must it satisfy to ensure the renewal term?

(e) Providing stability and a measure of predictability over the course of the franchise term by institutionalizing methodologies to ensure system adherence.

(f) To the extent possible, and as discussed earlier, anticipating changes within the system over the term of the franchise agreement. One approach to anticipate such changes would be to build enough flexibility within the franchise agreement so as to allow the franchisor with sufficient latitude to respond to new challenges over time. Franchise counsel traditionally does so by drafting largely generic agreements and leaving the specifics to the operations manuals. The operations manuals are then used by franchisors to institute new policies from time to time which, while not necessarily contemplated by the franchise agreement, are legally "sanctioned" by the franchise agreements since the manuals are incorporated by reference into the franchise agreement.

OVERVIEW OF KEY CONTRACTUAL TERMS

Parties to the Franchise Agreement

One of the first issues to address when drafting a franchise agreement is to determine the identity of the contracting parties. A franchisee may be an individual or a corporation or, in some cases, a partnership. Put simply, the obligations and debts arising under the franchise agreement are only binding on the parties to the agreement. For example, absent a personal guarantee, if a

corporate franchisee enters into the agreement, the individual shareholders of that corporation cannot be sued in their personal capacity for the debts and obligations of the corporation. The enforceability of the non-competition and confidentiality provisions of the franchise agreement must also be considered when deciding how to approach this issue.

Many franchisors require an individual to enter into the franchise agreement in his or her personal capacity, either in lieu of or in addition to the corporate franchisee. Where the franchise agreement is executed by an individual, some franchisors will permit an assignment of the agreement to a corporation controlled by the individual, but will usually require the individual to personally guarantee the obligations of the corporate franchisee. In addition, many franchisors will require that all of the principal shareholders of the corporate franchisee guarantee the debts and obligations of the franchisee, thereby imposing personal responsibility on the individual shareholders for fulfilling the obligations of the corporate franchisee.

As noted above, guarantees are important not only because the individual becomes personally responsible for the payment of fees and other monetary amounts under the franchise agreement, but because the individual is then subject to the same non-competition and confidentiality obligations imposed on the corporate franchisee.

Grant and Reservation of Rights

This provision is arguably the most important provision of any franchise agreement. Pursuant to this provision, the franchisee is granted the right, licence and privilege to operate a business selling authorized products and/or services in association with the franchisor's standards, procedures, methods, techniques, specifications, know-how and trade-marks. This licence is typically limited in both time and territory (as discussed further below). In addition, the licence may be exclusive, non-exclusive or exclusive within a specified territory. While it is important

that the franchise agreement carefully describe all of the rights granted to the franchisee under the agreement, it is equally important that the franchisor specifically carve-out all of the rights that it intends to reserve to itself.

In a non-exclusive licence, the franchisor provides no guarantee whatsoever that it will not directly or indirectly compete with the franchisee through corporate outlets or other franchisees. In an exclusive licence on the other hand, the franchisor agrees not to compete with the franchisee within a defined territory by refraining from operating the same business or granting a competing franchise within that same area. However, even where the franchisor has granted an exclusive licence, the franchisor will typically reserve certain enumerated rights to itself. For example, the franchisor may reserve the right to operate or license others to operate a competing business (either within or outside the franchisee's exclusive territory) using different trade-marks. In today's marketplace, the franchisor may wish to reserve the right to sell products and services by telephone sales, mail order or the Internet. A sample grant and reservation of rights clause is provided below.

> **Grant and Term**
>
> **Subject to the provisions of this Agreement, Franchisor hereby grants to Franchisee the right, license and privilege to operate the Franchised Business at the Premises for an initial term of five (5) years and to use the System and the Trade-marks in connection therewith.**
>
> **Reservation of Rights**
>
> **The Franchisee expressly acknowledges and agrees that, the rights granted to the Franchisee hereunder are non-exclusive, and the Franchisor expressly reserves the following rights:**
>
> **(a) the right to establish or operate, or license any other person the right to establish or operate, a [branded outlet] at any location outside the Exclusive Territory;**
>
> **(b) the right to develop, market, own, operate or participate in any other business under the Trade-marks or any other trade-marks; and**
>
> **(c) the right to distribute, sell or license other persons to distribute or sell non-System products and System Products whether within**

the Exclusive Territory or otherwise, through channels of trade other than traditional [branded outlets] such as kiosks, home delivery, centralized order taking, toll free telephone, mail order~~,~~ ~~electronic~~ mail and the Internet .

Term and Renewal

The term of the franchise agreement determines how long the franchisee will be authorized to carry on business using the franchisor's system and trade-marks. Normally, the grant of these rights is for a specified initial term (for example, 5 years or 10 years). The length of the initial term will vary depending on the nature of the franchised business, industry practice and the cost of the initial investment required by the franchisee.

In some cases, a franchisor will offer the franchisee a right of renewal for a further specified period of time. The renewal period may or may not be for the same period of time as the initial term. Usually certain conditions must be satisfied by the franchisee in order for it to exercise its right of renewal. For example, the franchisor may require that the following conditions precedent be met by a franchisee wishing to renew the franchise agreement beyond the initial term:

(a) the franchisee shall have substantially complied with all of the provisions of the franchise agreement and all other agreements between the franchisee and the franchisor during the term prior to renewal, and shall be in full compliance therewith at the end of the term prior to renewal;

(b) all monetary obligations owed by the franchisee to the franchisor shall have been satisfied in full prior to such renewal;

(c) the franchisee shall have made or agreed to make all reasonable capital expenditures required by the franchisor to renovate, refurbish, remodel, redecorate and modernize the premises so as to reflect the then current image of the franchised business;

(d) the franchisee shall have made or agreed to make all reasonable capital expenditures required by the franchisor to upgrade its equipment, systems or software;

(e) prior to the commencement of such renewal term, the franchisee shall have executed the franchisor's then current form of franchise agreement and all other agreements, instruments and documents then customarily used by the franchisor in the granting of franchises;

(f) the franchisee shall have given to the franchisor the required notice prior to the expiry of the current term of its intention to renew the franchise agreement;

(g) the franchisee shall have secured the right to remain in possession of the current premises or other premises acceptable to the franchisor throughout such renewal term; and

(h) the franchisee shall have paid to the franchisor the required renewal fee (often this renewal fee will be expressed as a percentage of the then current initial franchise fee being charged to new franchisees.

As noted above, the franchisee may be required to renovate its space or upgrade equipment or systems prior to exercising its right of renewal. This requirement enables the franchisor to ensure that long-time franchisees do not fall behind newer franchises in terms of appearance, standards and quality and also allows the franchisor to ensure consistency across all franchises regardless of the length of time a franchisee has been part of the system. As a result, it is more common for a franchise agreement to include an initial term of five years with an option to renew for one further five year period, than it is for the agreement to provide one single ten year term.

Territory

As noted above, the grant of the right to carry on the franchised business is usually limited to a defined territory. This territory may or may not be protected. The scope of the territory will vary depending on the nature of the franchised business. In some cases, the territory may be limited to the franchisee's actual premises, or parts of a shopping mall. In other franchise systems, the territory may be as large as an entire city or province.

Where the franchisor has decided to grant an exclusive right to carry on the franchised business within a defined territory, it is prudent to impose certain minimum performance standards on the franchisee. This will allow the franchisor to address situations where a franchisee may not be adequately serving the needs of all customers within the protected territory. Failure to meet or exceed the minimum performance standard may result in a reduction in the scope of the protected territory or the revocation of the franchisee's exclusive rights altogether.

An alternative approach seen in some franchise agreements is to provide the franchisee with a right of first refusal in the event the franchisor determines that the protected territory can support another franchise. In such event, and generally provided the franchisee is in full compliance with all of its obligations under the franchise agreement and meets the franchisor's financial and management capability requirements for multiple unit operators, the franchisor must first offer the new location to the existing franchisee in the protected territory. If the franchisee does not exercise its right of first refusal, then the franchisor is free to offer the franchise to a third party and to re-describe the existing franchisee's protected territory accordingly.

Protected Territory

In the event that Franchisor intends to establish or operate, or license any other person, firm or corporation to establish or operate, another Business within the Protected Territory, it shall first offer such Business to Franchisee on the same terms and conditions which would be offered to a

prospective Franchisee at that time. If Franchisee does not agree to acquire such Business on such terms and conditions within thirty (30) days after notice of such offer is given to Franchisee, Franchisor shall then be entitled to operate such Business directly or offer such Business to any person, firm or corporation upon substantially the same terms and conditions as are offered to Franchisee hereunder, whereupon the description of the Protected Territory set forth in Schedule "A" to this Agreement shall be deemed to have been reduced to reflect the creation of a new protected territory for the new Business, which new protected territory shall be determined by Franchisor in its discretion. The exercise of the right of first refusal in this Section ● by Franchisee shall be subject to the condition that Franchisee shall have substantially complied with all of the provisions of this Agreement and any other agreement to which Franchisor and Franchisee are parties and shall have complied with Franchisor's then current conditions and requirements for operators of multiple Business franchises including, without limitation, Franchisor's requirements for satisfactory financial resources and management ability.

Site Selection

A franchisor will wish to control the location of the franchised business, the construction of the store and the general appearance of the franchised unit, particularly when franchising in the retail store-front context. Where the franchise takes the form of a store-front operation, the location, nature and quality of the franchised site obviously assumes a much greater significance. This is because the franchisor will require that the site be consistent with the kind of image and branding that the franchisor wishes to project to the public. A properly selected and constructed site therefore is not only often critical for the success of the franchise itself, but is also an integral element of the franchisor's maintenance and promotion of its brand and the franchise system itself.

Where the selection of a site is an integral part of the brand protection strategy, a franchisor should first determine whether it or the franchisee should initiate the site selection process. Where a franchisee is given the task of selecting the site, the franchisor should nonetheless retain the right to approve or disapprove the location and appearance of the site so as to ensure that it meets the criteria of the franchisor. Site selection provisions therefore often contain language

that gives a franchisor the right to reject the franchisee's desired choice for a location. Where this is the case, a franchisor should provide its franchisees with a reasonable and objective rationale for its objections, even though the franchise agreement will not require an explanation from the franchisor. A reasonable explanation is helpful for the franchisee to then meet the franchisor's criteria and to proceed with a better choice of a location at a later time.

In addition to actually reserving the right to select the franchised site on behalf of its franchisees, a franchisor will often wish to retain the right to either construct the store itself or to ensure that the franchisees utilize only building plans, contractors and constructions supplies approved by the franchisor. Depending on the level of control desired, a franchisor will in any event wish to participate at some level in the construction process so that, at a minimum, its trade-marks and overall branding are protected.

Another important element of the site selection provisions pertains to the identity of the party entering into the lease for the real property for the franchised location. A franchisor may enter into the lease itself and then sublease the franchised site to its franchisee or it may allow the franchisee to enter into the lease itself, provided that the lease contains certain provisions that protect the franchisor, its trade-marks and the franchise system. Alternatively, or in any event, a franchisor may wish to simply negotiate the lease for the franchised location with the landlord on behalf of its franchisee. A franchisor does the latter to ensure that the lease does not contain provisions that might prevent the franchisee from operating the franchised business at the leased location in the manner contemplated by the franchise agreement, to allow a franchisor to sublet the premises without first obtaining the consent of the landlord in the event that it is on the head lease, and for other various related reasons. Once again, a critical concern for the franchisor is to ensure the location's suitability for the franchisee and ultimately the franchise system,

particularly if the franchise is terminated and another franchisee is to replace the terminated franchisee at the relevant site.

In any case, the franchise agreement should make clear that the selection and securing of a site, review of documents and the negotiation of a lease, the selection of developers, real estate agents, site selection specialists, contractors, etc., financing, construction, build out, compliance with local requirements, suitability for any use or purpose and/or any other aspect of the development process and all other matters related in any way to the franchisee's site are exclusively and entirely the franchisee's sole and ultimate responsibility, even when the franchisor provides assistance in this regard. The franchise agreement should further explicitly stipulate that neither the franchisor nor any other person or company affiliated or associated with the franchisor is in any way liable with respect to any matters related to the site selection process, all such responsibilities being solely the franchisees. Alternatively, and as noted above, a franchisee may be encouraged to perform more of the site selection duties, that is, to obtain, at its sole expense, all qualified architectural and engineering services to prepare surveys, site and foundation plans and adapt any plans and specifications for its location and to otherwise construct the store all in accordance with applicable laws, regulations and by-laws and the franchisor's requirements. In this fashion, the franchisee benefits from participating in the site selection and construction process, and is thereby possibly less likely to feel aggrieved should anything go awry.

Finally, a franchisor should clearly state that it has made no representations, guarantees or otherwise as to the costs of development and build-out of the franchised store, the date on which the franchise will be open for business or otherwise, such matters often not being within the franchisor's sole control. The franchisor's review of and/or consent to any plans (or

modifications) submitted by the franchisee, its development, construction and/or other activities, and the franchisor's provision of any plans or other assistance, or otherwise, should be solely identified in the franchise agreement as being for the purpose of determining compliance with the franchisor's system standards and the franchisee should be held solely responsible for constructing and operating its franchise in compliance with all applicable legal requirements.

Initial and Ongoing Franchise Fees

There are several different types of payments generally owing under a typical franchise agreement. Most franchise agreements require the payment of a one-time initial franchise fee and an ongoing royalty fee. In addition, many franchise systems require franchisee to contribute to a marketing fund by way of an ongoing advertising fee. Each of these franchisee fees is discussed in greater detail below.

(a) **Initial Franchise Fee**

The initial franchise fee represents the fee payable by the franchisee for the right, licence and privilege to operate the franchised business using the franchisor's system and trade-marks. The initial franchisee fee is usually due upon execution of the franchise agreement and is typically acknowledged to be fully earned and non-refundable. In certain circumstances, some franchisors may refund the initial franchise fee. For example, where a franchisee has failed to demonstrate the qualities and abilities which the franchisor deems necessary for the successful operation as a franchisee or if the franchisee fails to complete the initial training program, the franchisor may reserve the right to terminate the franchise agreement and, in the event of such termination, refund the initial franchisee fee, less the franchisor's reasonable administrative, supervisory, accounting, training and legal costs.

Where the franchisor requires a deposit fee in order to process a prospective franchisee's application, the deposit is usually deducted from the initial franchise fee. The initial franchise fee is distinguished from training fees, construction or development costs and other costs associated with opening the franchised business.

The amount of the initial franchise fee will vary greatly depending on the nature of the franchised business. For example, a small home-based franchisee may be required to pay an initial fee of $1,000, while a franchisee entering into an agreement with a mature, well-established restaurant or hotel franchise system may be required to pay an initial fee of $75,000 or more.

(b) **Royalty Fees**

The majority of franchise systems will require franchisees to pay an ongoing periodic royalty fee. The royalty fee is the primary vehicle through which franchisors generate ongoing revenues from franchisees. These fees are usually expressed as a percentage of "gross sales" and are typically payable on a weekly or monthly basis. For example, a typical royalty fee for an established restaurant chain may be in the range of four to six percent of the franchisee's gross sales. It is increasingly common for the franchisor to require weekly payment of royalty fees by way of electronic funds transfer from the franchisee's bank account.

Since the royalty fee is typically based on gross sales, "gross sales" is one of the most important definitions under any franchise agreement. The parties should pay careful attention to what is and is not included in such definition. A sample definition of "gross sales" is provided below.

> **"Gross Sales" means the aggregate of all sales and other income of Franchisee from whatever source derived, whether or not collected by Franchisee and whether for cheque, cash, credit or otherwise, arising out of, in connection with or relating to the Franchised Business including, without limitation, all proceeds from any business interruption insurance**

but excluding all refunds and discounts made in good faith to arm's length customers, any sales, goods and services and equivalent taxes which are collected by Franchisee for or on behalf of any governmental or other public body and actually remitted to such body, and the value of any coupon, voucher or other allowance authorized by Franchisor and issued or granted to arm's length customers of the Franchised Business which is received or credited by Franchisee in full or partial satisfaction of the price of any item or service offered in connection with the Franchised Business;

(c) **Advertising Fees**

In addition to the requirement to pay royalty fees, franchisees are often required to pay an ongoing advertising or marketing fund fee. Advertising fees are also typically based on a percentage of gross sales, albeit usually a smaller percentage than the royalty fee. The creation and use of an advertising fund is discussed in greater detail below.

Records and Reporting Obligations

The franchise agreement will typically impose a number of record keeping and reporting obligations on the franchisee. For example, franchisees are usually required to submit the following reports to the franchisor:

(i) complete and accurate records of gross sales for the preceding reporting period together with an income statement for such period;

(ii) income statements and balance sheets;

(iii) copies of all federal and provincial income, sales and goods and services tax returns submitted by Franchisee for any period;

(iv) annual audited or unaudited financial statements prepared by an independent chartered accountant approved by the franchisor detailing the performance of the franchised business; and

(v) such financial or other reports relating to the operation of the franchised Business as the franchisor may reasonably require from time to time.

For the sake of consistency and to facilitate the reporting process, franchisees will often be required to use the franchisor's approved accounting, record keeping, reporting and computer systems. These reporting obligations help the franchisor to ensure that royalty and advertising fees have been calculated accurately. Moreover, the franchisor will usually reserve the right to audit all records, books of account and tax returns. The cost of such an audit is typically borne by the franchisor, unless the audit reveals an underpayment by the franchisee of a predetermined threshold percentage in which case the franchisee will typically bear the cost of the audit.

Trade-mark Protection

A significant portion of the franchise agreement is dedicated to provisions which protect the trade-marks of franchisors. This is not surprising given just how important trade-marks are for the success and growth of franchise systems. Trade-marks are, without a doubt, at the core of any successful franchise program. Without adequate protections in place, franchisors are at risk of losing any goodwill associated with their trade-marks and their franchise systems.

As such, it is important to ensure that the definition of "trade-marks" is defined as broadly as possible so as to give the franchisor the ability to add or remove any trade-marks during the course of the franchised relationship. "Trade-Marks" should include not only those trade-marks, logos and trade names specifically listed in the franchise agreement but also any others presently or subsequently used by the franchise system as may be set out in the franchisor's operations manual and not later withdrawn.

With the proliferation of computers and the Internet, furthermore, a franchisor's task in this regard has become exponentially more complex and difficult to manage. In an instant, respectable trade-marks are at risk of being used and abused by third party usurpers who have no regard for the trade-marks and the goodwill attached to them. Franchise agreements therefore should include provisions which specifically address the use of trade-marks and other intellectual property on the Internet.

Since the abolition of the registered user requirements under the *Trade Marks Act* R.S.C. 1985, c. T-13 in 1993, a franchisor is no longer required to file with the Trade-marks Office a registered user document for each franchisee and for each trade-mark used by the franchisor. Instead, franchisors are now required under Section 50(1) of the *Trade Marks Act* to authorize their franchisees to use the franchisors' trade-marks and to control their franchisees' use of such marks:

> **50.** (1) For the purposes of this Act, if an entity is licensed by or with the authority of the owner of a trade-mark to use the trade-mark in a country and the owner has, under the licence, direct or indirect control of the character or quality of the wares or services, then the use, advertisement or display of the trade-mark in that country as or in a trade-mark, trade-name or otherwise by that entity has, and is deemed always to have had, the same effect as such a use, advertisement or display of the trade-mark in that country by the owner.

Control of the trade-marks may be exercised by the franchisor providing its franchisees with guidelines as to the proper use of the franchisor's trade-marks, establishing a compliance program for monitoring the use by the franchisee of the trade-marks and by regularly inspecting the goods and/or services which display such trade-marks to ensure that they are being displayed in a manner acceptable to the franchisor. Failure to implement these controls could jeopardize the validity of the franchisor's trade-marks, as it is only through the trade-mark license

agreement that a use of the trade-mark by a third party (in this case, a franchisee) would be deemed to be use of the trade-mark by the franchisor.

To adequately protect the trade-marks, the franchisor should provide for the following in its franchise agreement:

- The franchisee should acknowledge both in the franchise agreement and in a public manner that the trade names and trade-marks owned or licensed by the franchisor are the sole property of (or under license by) the franchisor and are exclusively owned by or licensed by the franchisor. For instance, a franchisor should insist that its franchisees post a sign at the franchised location and/or on its letterhead indicating that such franchisees are licensees of the marks and are franchisees of the system. Such a requirement could have other very important benefits as well. For example, it could assist the franchisor in its attempt to avoid any potential vicarious liability for the acts, omissions or negligence of its franchisees.

- The franchisee should agree that it will not impair, abrogate or contest the ownership of such trade names or trade-marks and that its rights to use same is limited to the operation of the franchised business and that its usage must be in compliance with the franchise agreement and all applicable law.

- The franchisee should acknowledge that all goodwill generated by the use of the trade names or trade marks will enure to the benefit of the franchisor and agree that upon the termination or expiration of the franchise agreement, the franchisee will not identify itself as a franchisee or former franchisee of the franchisor.

- The franchisor should also place very specific and detailed limitations on the franchisee's usage of the trade names, trade-marks and system owned or licensed by the franchisor, whether used in association with the franchisee's stationary, contracts, signs, menus, advertising or websites.

- The franchisee should be required to notify the franchisor of any infringements of the franchisor's trade-marks and to give the franchisor further assurances that it will take

whatever steps are necessary to protect the interests and rights of the franchisor in this regard.

- The franchisor should require the franchisee (and the franchisee shall cause its employees, contractors and agents) to maintain the confidentiality of all trade secrets and confidential information belonging to the franchisor and to develop procedures to ensure that the franchisee or its employees, contractors and agents do not breach this covenant.

- Franchise systems often involve the use of certain distinctive trade dress such as colour schemes, uniforms, and building decor and these should also be protected by the franchisor as with the other intellectual property in the manner referred to above.

- Finally, appropriate language should also be inserted into the franchise agreement that gives the franchisor complete control over the registration, prosecution of any infringement and abandonment of the said trade-marks.

Authorized Suppliers and Volume Rebates

It is generally agreed that it is in the best interest of the franchise system as a whole that the uniform standards, methods, procedures, techniques and specifications of the franchisor's system be fully adhered to by all franchisees. Accordingly, most franchise agreements require that the franchisee offer for sale only those products and services, and use and install only such inventory, equipment, signs, furnishings, forms and other items, as are from time to time authorized in writing by the franchisor. The franchise agreement will typically require the franchisee to purchase all such products and services from the franchisor, an affiliate of the franchisor or a franchisor-approved supplier.

One of the corollary benefits of requiring this uniformity in products and services is that the franchisee can take advantage of the franchise system's volume purchasing. In many cases, the franchisor may realize a profit or receive rebates, discounts or other allowances as a result of such bulk purchasing by franchisees and corporate outlets. While such profits or allowances

need not be shared with franchisees, the existence of such profits or allowances should be disclosed to franchisees. For example, if applicable, the franchise agreement should contain the following language:

> **Franchisee shall have the right to participate, on the same basis as other franchisees of Franchisor, in group purchasing programs for products, supplies and services which Franchisor may from time to time use, develop, sponsor or provide. Franchisor may, from time to time, receive rebates, discounts or other allowances in respect of such group purchasing programs which Franchisor shall be entitled to retain for its own use and credit without accounting to Franchisee in respect thereof.**

In the event the franchisee desires to obtain products or services from suppliers other than those pre-approved by the franchisor, the franchise agreement should include a detailed approval process. Such a process will typically require the franchisee to provide samples or submit to certain testing and to obtain the franchisor's approval before sourcing a product or service from outside of the system.

Security

It is common for a franchisor to take a security interest over the franchisee's assets. This is especially the case where the franchisor or an affiliate of the franchisor is the sole or primary supplier of products and services to the franchisee.

As security for the payment and/or performance by the franchisee of its obligations under the franchise agreement or under any other agreement or arrangement with suppliers to the franchisee, the franchise agreement will include a provision requiring the franchisee to enter into such agreements and execute such documents as may be requested by the franchisor or such suppliers, including the execution of security documentation and guarantees. Such security is usually taken by way of a general security agreement. The franchise agreement and general security agreement should contain a cross-default provision.

The security interest must be registered and perfected in accordance with applicable provincial laws. The franchisor should ensure that it has filed the necessary documents in the personal property registry system of each province in which the franchisee is carrying on business.

Advertising

As noted above, franchisees may be required to contribute to an advertising fund. Such advertising funds are typically created in recognition of the value of standardized advertising and promotion of the franchise system on a national and/or regional basis. National and/or regional advertising funds are more common where the franchise is an established and mature system.

Typically the franchisor will be responsible for all decisions relating to the maintenance, direction and administration of the advertising fund and the selection of the particular media (i.e., radio, television, Internet or print). At a minimum, the franchise agreement should address the following issues related to advertising:

(i) Will the advertising fund be accounted for separately from other funds of the franchisor?

(ii) Will the advertising fund be used to defray any of the franchisor's administrative, personnel and overhead costs incurred in relation to the administration or direction of the advertising fund?

(iii) How will the expenditure of the advertising fund contributions be accounted for?

(iv) Will the franchisor's corporate outlets be required to contribute to the advertising fund?

(v) Will franchisees also be required to expend a specified minimum amount on local advertising?

(vi) Will there be any restrictions on the franchisee's ability to advertise in telephone directories, on the Internet, on websites or through electronic mail?

Operations Manual

Operations manuals form an integral part of any franchise system since they are designed to incorporate all of the franchisor's standards, requirements, operating procedures and policies necessary to operate the franchised business in a manner consistent with the franchisor's system. By virtue of certain provisions in the franchise agreement that incorporate the operations manual into the franchise agreement, the operations manual is deemed to form a part of the franchise agreement itself.

It is virtually impossible for a franchise agreement to contain details of each and every of its standards. Given this fact, the fluctuating nature of the franchised relationship and the often lengthy duration of the franchise agreement, it is important that the definition of "operations manual" be as flexible as possible to accommodate changes to the system. The definition, therefore, should not only include the form of the manual which was presented to the franchisee at the commencement of the franchise, but also any future amendments, deletions and additions to the said manual (along with all books, pamphlets, bulletins, memoranda, directives, instructions and other materials) and any directives, letters, documents, programs or communications communicated by franchisor to the franchisee from time to time during the currency of the agreement.

The franchisor should also be given broad latitude by the franchise agreement to amend and to replace the manual from time to time to allow it the ability to address new developments in the system. A franchisor should retain the right to supplement its manual with additional information by emailing such information to its franchisees or by posting the amendments on its website, for example. Despite the seemingly wide latitude afforded to franchisors to issue new policies through the manual in this manner, it is not advisable for franchisors to abuse this privilege by unreasonably amending significant terms and conditions of the franchise agreement in a substantial manner by way of the operations manual.

The franchise agreement should make it clear that the manual is being loaned to the franchisee, rather than given or sold to it to protect the confidentiality of the manuals. Upon termination of the franchise relationship, a franchisee should be obligated by the franchise agreement to promptly return the manual and all copies thereof to the franchisor. Franchisees should also agree to maintain the confidentiality of the operations manual (other than the usual exceptions to confidentiality, i.e., except as may be required to conduct their business or as may be required by law). Franchisees should also acknowledge that at all relevant times they had no part in developing the operations manual.

Franchisees are required to operate their franchised businesses strictly in accordance with their franchisor's operations manual. The franchisee's failure to meet the standards set out in the manual on a regular and persistent basis should be an event of default, which may warrant termination. Depending on the circumstances, even one violation of a serious operations manual requirement may justify termination of the franchise agreement.

Training and Operating Assistance

Another key element in the success of any franchise system is the training and operating assistance offered by franchisors to their franchisees. A franchisor will require its franchisees to attend its initial training sessions to provide the franchisees with the necessary training and support to successfully launch and operate a franchise. A franchisor may require that all staff training at the franchisee level be made under their guidance and control and that the franchisees and their personnel successfully complete the necessary training before such franchisees are accepted as franchisees into the system.

In addition to the initial training, a franchisor will often offer ongoing operating assistance in such areas as the selection and purchasing of products, assistance in advertising campaigns, hiring and training employees, bookkeeping services, improvements to the system and general advice to the franchisees. Further, a franchisor may offer refresher-training courses from time to time to bring the franchisees up-to-date on new procedures and developments. Finally, a franchisor should reserve the right to require under-performing franchisees to undergo additional training. In each case, the franchisees should then, in turn, be required by their franchise agreements to train their employees in a manner consistent with the franchisor's requirements.

The franchise agreement should identify who should bear the initial and ongoing training costs of the franchisees and their personnel. A franchisor will often require that its franchisees assume the cost of travel to and from training sites (no matter where the training site might be) and that the franchisees train their own employees at their own expense.

Insurance

The typical franchise agreement will require the franchisee to purchase and maintain at all times during the term of the agreement such policies of insurance and in such amounts as the

franchisor may reasonably require. Alternatively, the franchisor may establish a group insurance program and require franchisees to contribute to same.

In many cases the franchisor may require that it be named as an additional insured party to get the benefit of the insurance and typically will require the franchisee to provide proof of insurance upon request. Examples of the types of insurance a franchisor may require are comprehensive general liability, property damage, business interruption, employee honesty and liability, inventory and fire insurance. Such insurance is intended to protect both the franchisee and the franchisor.

In the event that the franchisee does not maintain the required insurance, the agreement may provide that the franchisor can obtain such insurance from an insurer selected by the franchisor and keep the same in full force and effect at the sole expense of the franchisee.

Termination

The franchise agreement may simply expire at the end of the initial term or, if applicable, at the end of the renewal term. In addition, the franchise agreement sets out certain events of default by the franchisee which may form the basis of an early termination of the agreement by the franchisor. Certain events of default may be cured by the franchisee (i.e., failure to pay royalty fees, failure to file required reports), whereas others may result in the immediate termination of the franchise agreement (i.e., bankruptcy or insolvency of the franchisee, abandonment of the franchise). Even in the case of a curable default, most franchise agreements will provide the franchisor with a further ground of termination where the franchisee has received a specified number of notices of defaults within a certain period of time (whether or not such defaults have been cured by the franchisee).

It is common for franchisor's to reserve the right to terminate the franchise agreement at the very early stages of the relationship in the event the franchisee fails to demonstrate the qualities and abilities deemed necessary for the successful operation of the franchised business or the franchisee fails to complete the initial training program to the satisfaction of the franchisor, acting reasonably. Where the agreement is terminated at this early stage, the franchisor will often refund the initial franchise fee less its reasonable administrative, supervisory, accounting, training and legal costs.

Most franchise agreements will also include a cross-default provision which enables the franchisor to terminate all agreements between the franchisor (or its affiliate) and the franchisee in the event of a default by the franchisee under any one agreement. For example, the agreements may be drafted such that a failure to pay rent owing under the sublease agreement is deemed to be a default under the franchise agreement as well, thereby allowing the franchisor to terminate both the sublease and the franchise agreement.

The franchise agreement will also set out the franchisee's obligations upon the termination or expiration of the agreement. A sample list of post-termination obligations of the franchisee is set out below:

(d) pay to the franchisor and its affiliates all amounts owing under the franchise agreement or any other agreement between the franchisee and the franchisor or any such affiliates;

(e) return to the franchisor all copies of the operations manual;

(f) notify the telephone company and all listing agencies of the termination or expiration of the franchisee's right to use all telephone numbers and all classified and other directory listings of the franchised business and that any telephone

numbers of the franchised business have been assigned to the franchisor and, at the franchisor's option, assign such telephone numbers to the franchisor;

(g) assign all Internet and website addresses, e-mail addresses and domain names using the franchisor's trademarks to the franchisor;

(h) cease to operate the franchised business under the franchisor's system or otherwise and thereafter not, directly or indirectly, represent to the public that such franchised business is operated in association with the franchisor's system, or hold himself or herself out as a present or former franchisee of the franchisor;

(i) cease to use, directly or indirectly, in advertising or in any other manner whatever the franchisor's trade-marks, any name or mark similar to the trade–marks, any other identifying characteristics or indicia of operation of the franchisor's system, and any confidential standards, methods, procedures and specifications associated with the franchisor's system;

(j) take all such action as may be necessary to cancel any trade or business name registration which contains any part of the trade-marks;

(k) permit the franchisor to enter the franchisee's premises and remove any and all personal property of the franchisor and any and all personal property of the franchisee which displays the franchisor's trade-marks or any distinctive feature or device associated with the franchisor's system; and

(l) comply with the franchisee's post-termination obligations of confidentiality and non-competition (see further discussion below).

Perhaps not surprisingly, the franchise agreement will not typically contain many provisions dealing with the franchisor's post-termination obligations. In many cases, however, the franchise agreement will provide the franchisor with an option to purchase some or all of the assets used by the franchisee in the operation of the franchised business based on a pre-determined formula. For example, the franchisor may want the option to purchase all or part of

the franchisee's leasehold improvements, inventory, branded products or materials, furniture, fixtures, equipment or other assets used in connection with the operation of the franchised business. Such a provision is usually structured as a right or an option, as opposed to an obligation to buy back part or all of the assets. A sample option to purchase provision is provided below:

> **Franchisor shall have the option to purchase from Franchisee all or any portion of the equipment, moveable leasehold improvements, furniture, fixtures, inventories and other assets located on the Premises or otherwise held by Franchisee in connection with the Franchised Business, such option to be exercised by Notice delivered to Franchisee within thirty (30) days of the date of the termination or expiration of this Agreement for any reason whatsoever. The purchase price payable to Franchisee for any such inventories shall be the lower of their cost or net realizable value, less a re-stocking charge equal to twenty-five percent (25%) of such purchase price. The purchase price payable to Franchisee for any such equipment, moveable leasehold improvements, furniture, fixtures and other assets shall be their fair market value as determined by Franchisor's auditors (but not allowing for any amount for goodwill). Any purchase and sale completed by Franchisor pursuant to this Section shall be completed in accordance with all applicable bulk sales legislation.**

Transfer and Assignment

The franchise agreement should contain specific provisions dealing with the transferability and assignability of the agreement and the parties' respective rights and obligations under the agreement. Typically, there are no restrictions on the franchisor's ability to assign the franchise agreement. The franchise agreement, however, will usually restrict the franchisee's ability to assign the agreement and its rights and obligations under the agreement unless certain conditions are met. These restrictions are due, in part, to the fact that the franchisor's decision to grant the franchise in the first place was based on factors that are specific to the franchisee's qualifications to operate the business. As a result, the grant of rights is typically acknowledged by the parties to be personal to the franchisee.

The franchisee's ability to sell, assign, transfer or mortgage or otherwise dispose of its interest under the franchise agreement will usually be subject to obtaining the prior written consent of the

franchisor. In addition, the franchisor may impose certain conditions which must be satisfied before the franchisor will grant its consent. For example, the franchisor may require that the proposed transferee be acceptable to the franchisor and have completed all necessary training, that the existing franchisee be in full compliance with all of its obligations under the franchisee agreement and any related agreements and have executed a complete release of the franchisor from all of its obligations under the franchise agreement, payment of any applicable transfer fee, and that the transferee enter into the franchisor's then-current from of franchise agreement.

The franchise agreement may also provide the franchisor with a right of first refusal where the franchisee has received a third party offer to purchase the franchise. Specifically, the agreement may require the franchisee to present every firm third party offer to the franchisor, together with information on the specific terms and conditions of such offer. The franchisor then has a specified period of time within which to decide whether or not to purchase the franchise on the same terms and conditions as set out in the third party offer. The agreement should also specify that where the franchisor elects not to purchase the franchise, the proposed transferee remains subject to the same standard approval process for all transfers and that the transfer remains subject to the franchisor's prior written consent.

Restrictive Covenants

A franchisor should do its utmost to protect its investment in its franchise system. To that end, franchisors will require that the franchisee *and* its shareholders, directors and officers (if a corporation) and its partners (if a partnership) refrain from competing directly or indirectly with the franchisor's business during the term of the franchise agreement ("in-term covenant") and thereafter ("post-term covenant"). If an employee of the franchisee who is not a director or

officer of the franchisee is an integral part of the franchise system, it is advisable that the franchisor require in-term and post-term covenants against competition from that person as well.

Many franchisors in attempting to prevent such competitive behaviour have incorporated into their franchise agreements language similar to the following terminology:

> **Franchisee shall not engage in any business operating in competition with or similar to the Franchised Business or franchise businesses similar to the Franchised Business.**

However, wording such as "similar to or competitive with" is too ambiguous and broad in scope and may be void on the grounds of public policy. This is so because such a provision could be interpreted to mean that a franchisee formerly operating a donut shop may not then operate a hamburger franchise upon termination, as such franchises may be technically seen as "competitors" of each other since they may be competing for the same customers. While franchisors may legitimately wish to prevent precisely that kind of competitive behaviour, the courts may view such clauses as being too broad and restrictive in nature and therefore unenforceable.[1]

Generally speaking, Canadian courts favour the principle of freedom of contract. Although this is the case, provisions of this kind will only be enforced if they are reasonably necessary to protect a legitimate interest of the franchisor and are at the same time reasonable from a public interest point of view, as the courts are reluctant to enforce restrictive covenants that are "in

[1] See Magnetic Marketing Ltd. v. Print Three Franchising Corp. (1991), 38 C.P.R. (3d) 540 (B.C.S.C.) where a non-competition provision was held to be too broad and therefore unenforceable. See, however, Enco Seat Covers Ltd. v. Enco Auto Trim & Glass (Newmarket) Ltd. (1993), 8 B.L.R. (2d) 20 (Ont. Gen. Div.), additional reasons at (1993), 8 B.L.R. (2d) 20n (Ont. Gen. Div.) where a three year non-competition covenant was enforced by the courts notwithstanding the use of ambiguous language not so dissimilar than the language found to be offensive by the court in the Magnetic Marketing case referred to above.

restraint of trade". Courts will consider the geographic scope of the territory, the number of years for which the restrictions apply and the type of business activity that is being restricted. Generally speaking, the more narrow the restriction, the more likely it is that the courts will enforce such activities. This is one of those occasions where the old adage "less is more" has particular resonance.

Generally speaking, Canadian courts will likely not enforce restrictive covenants that are in excess of two (2) years and at territories that are broader than the scope of protection reasonably required under the circumstances. Furthermore, courts are more likely to enforce a restrictive covenant in a scenario involving a voluntary sale of a franchised business by a franchisee, than when the franchisee is terminated by the franchisor on a without cause basis, for example. Courts are also less likely to enforce a non-competition covenant that restricts the departing franchisee from operating in the area *outside* of the franchisee's former territory, rather than a covenant that simply prohibits the franchisee from competing *within* the said territory. The Courts will also have difficulty enforcing a non-competition covenant in an area where the franchisor has no franchisees in operation.

The leading case in Canada regarding the enforcement of non-competition clauses in an employment scenario is *Elsey v. J.G. Collins Insurance Agencies Ltd., [1978] 2 S.C.R. 916,* where the Supreme Court of Canada held that:

> "A covenant in restraint of trade is enforceable only if it is reasonable between the parties and with reference to the public interest. As in many of the cases which come before the courts, competing demands must be weighed. There is an important public interest in discouraging restraints on trade, and maintaining free and open competition unencumbered by the fetters of restrictive covenants. On the other hand, the courts have been disinclined to restrict the right to contract, particularly when that

> right has been exercised by knowledgeable persons of equal bargaining power."

Interestingly, the Supreme Court commented that it is only in "exceptional cases" that a non-competition covenant is justified as opposed to a non-solicitation prohibition. It is where the "proprietary interest of the employer" is in need of protection that a non-competition covenant may be in order. Arguably, a non-competition covenant will be deemed to be enforceable in the franchising context as well, given the proprietary interest that needs to be protected by the franchisor for the franchise system to survive and prosper.

Canadian courts are more likely to enforce such covenants when they involve a purchase and sale of a business, where the vendor of the purchased business is in theory compensated (i.e., by way of the purchase price) for agreeing to provide the restrictive covenants in favour of the purchaser. If an employee is terminated on a without cause basis, however, the Courts will have a more difficult time enforcing wide-ranging covenants as against the terminated employee, particularly when the employee is seen as being unfairly constrained from pursuing his or her livelihood. The Supreme Court's analysis in *Elsey*, while pertaining to an employer-employee relationship, is nevertheless instructive when drafting non-competition covenants in the franchising scenario as it provides us with some guidance as to what the Courts will consider reasonable in this regard.[2]

One hurdle that a franchisor may face in enforcing its non-competition covenant, however, is when unequal bargaining power is evident as between the franchisor and the franchisee. In such

[2] The Ontario Court of Appeal case of Lyons v. Multari, (2000) 50 O.R. (3d) (Ont. C.A.) cited *Elsley* with approval by holding that a non-competition covenant may be unenforceable if a non-solicitation clause is sufficient to protect an employer's interests. Once again, franchisors are advised to seek out legal counsel when crafting these types of restrictive covenants in their franchise agreements.

a case, the Courts, relying upon the reasoning of *Elsley*, may refuse to uphold the non-competition covenant in favour of supporting the right of the departing franchisee to contract.

Since there is a risk that the Courts may find some or all of the restrictive covenants unenforceable, drafters of these covenants will often incorporate language on the severability of these provisions of a franchise agreement. That is, where any term or condition of the agreement is considered invalid or unenforceable, all other terms and conditions of the agreement are deemed not to be affected thereby and each term and condition of the Agreement are considered to be separately valid and enforceable to the fullest extent permitted by law. In this manner, a Court may deem the offensive provision invalid, without affecting the enforceability of the balance of the agreement.[3]

Finally, franchisees should acknowledge in their franchise agreements that franchisors are entitled to pursue injunctive relief should the franchisees breach their restrictive covenants and that any claims that the franchisees may have as against their franchisors shall not constitute a defence to the enforcement of any of the restrictive covenants by the franchisors.

Resolution of Disputes

Many franchise agreements include specific clauses dealing with alternative dispute resolution procedures, such as mediation or arbitration. One approach is to require that the parties first exhaust these alternative procedures before suing the other party in court. Another approach is to require that the franchisee and franchisor settle all disputes through mediation or arbitration.

[3] It is instructive to note in this regard the decision of the Supreme Court of British Columbia in TMI Turf Management Ltd. v. R. De Noble Enterprise Limited (http://www.canlii.org/bc/cas/bcsc/1993/1993bcsc10777.html) in which the court enforced a 2-year non-competition provision (which contained a drop-down clause and severability language common to many non-competition provisions) on the grounds that it would have been prejudicial to the franchisor if the ex-franchisee had been allowed to operate its identical business after its franchise agreement was terminated.

This type of arbitration clause would typically specify that the arbitration is final and binding and that neither party has the right to appeal the decision of the arbitrator. The franchise agreement should also specify the rules that will apply to the arbitration, how the arbitrator or panel of arbitrators will be selected and the jurisdiction of the arbitration. The logic behind these alternative dispute resolution processes is that they allow the parties to select an arbitrator or mediator who is familiar with the unique aspects of franchising and has experience in dealing with franchise disputes.

Despite the fact that mediation and arbitration have been recognized more generally as a viable alternative to litigation, it remains relatively uncommon for a franchise agreement to impose mandatory and binding mediation or arbitration. This is due, in part, to the fact that arbitration has generally proven to be no less costly than traditional litigation and, in many cases, can prevent a franchisor from obtaining injunctive relief in order to enforce its rights upon termination of the franchise agreement.

CONCLUSION

We have set out above a discussion of certain key contractual terms and issues raised by the unique aspects of the franchise relationship. A well-drafted franchise agreement is key to ensuring a strong franchise system and a mutually beneficial and productive franchisor/franchisee relationship. This paper highlights many of the drafting issues unique to the franchise relationship.

More than simple drafting skills and an understanding of the franchisor's business operations and objectives are required in order to prepare franchise agreements and related documents that address issues specific to franchising. Legal counsel must be well versed in many aspects of commercial law and must keep apprised of developments in the common law relating to or

affecting the franchise relationship in order to effectively advise franchise clients. It is incumbent on all franchise counsel to keep pace with the continuing evolution of franchise law and the impact of these changes on franchise agreements and related documents.

Joseph Adler is a partner with the law firm of Hoffer Adler LLP in Toronto, Ontario. He can be reached at 416-977-3444 and at jadler@hofferadler.com.

Andraya Frith is a senior associate of Osler, Hoskin & Harcourt LLP in Toronto, Ontario. She can be reached at 416- 862-4718 and at afrith@osler.com.