

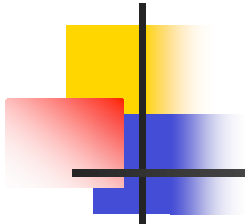


CFA – Franchise Show

- Signing in the Dotted Line: Legal Issues
- February 19, 2006

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HOFFER ADLER LLP

BARRISTERS & SOLICITORS • TRADE-MARK AGENTS

- 32 years of collective legal experience
- Joseph Adler, B.A., LL.B., M.A.
 - Counsel to Franchisors (domestic and international), Franchisees and those who wish to franchise their businesses
 - Member of the CBA, ABA, CFA, ABA Forum on Franchising, IFA, Legal and Legislative Affairs Committee of the CFA
 - Writer and speaker
- Lloyd Hoffer – experienced litigator



Overview

- CDN Franchise Market
- Definitions
- Pros and Cons to Franchising
- Selecting a Franchise
- Legal Documents
- Disclosure Document
- Avoiding the Pitfalls



Canadian Franchise Market

- Franchised businesses in Canada account for over \$100 billion in annual sales
- Represent 40 cents out of every retail dollar spent in Canada
- In Ontario, there are estimated to be 1,350 franchisors and 80,000 franchisees



Popular Franchising Concepts

- Fast Food
- Restaurants
- Automotive
- Lodging
- Business Services
- Educational
- Professional





Definitions

- Franchise, Franchisor and Franchisee –

Grant of rights to market a product or service under a certain brand (Trade-mark) by one party (Franchisor) to another (Franchisee) for a sum of money under the guidance or control of the Franchisor



Franchise

- Sale of a promise
- Three Cs
 - Consistency
 - Control
 - Cash



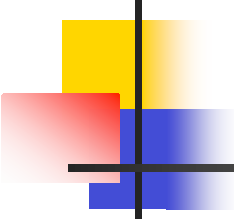
Why Companies Franchise

- Expand their Sources of Financing
- Faster Penetration
- Limited (or Shared) Liability
- Motivated Operators

Advantages of Being a Franchisee (1)

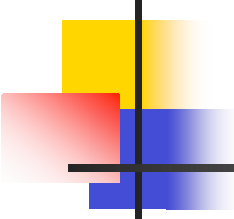


- Brand Recognition –
 - Established Product/Service
- Proven Operating System (Manual)
- Support (Initial and Ongoing)
- Training (Initial and Ongoing)
- Financing and Site Location Assistance



Advantages of Being a Franchisee (2)

- “Monitored Independence”
- R & D
 - Market research – demographics, trends
- Association with other Franchisees
- Consistency
- Quality assurance
- Food safety compliance tools



Advantages of Being a Franchisee (3)

- Kitchen display systems
- Enhanced buying power
- Product source management
- Point of sale systems
- Efficient ergonomics and structure
- Increased chance for success
- Reduced risk of failure



Disadvantages of Being a Franchisee

- Not completely independent
- Less Control
- Payment of royalties and other fees from gross sales (i.e., smaller margins)
- Goodwill could turn to bad will
- Limited term
- Risk of Encroachment



Before Buying a Franchise...

- Determine what you enjoy
- Prepare a business plan
- Purchase a copy of the CFA's Franchise Directory and survey the kinds of franchises available
- Check the CFA website (www.cfa.ca)
- Retain professionals (franchise lawyer, accountant and franchise consultant)



Before Buying a Franchise (2)

- How much can you invest?
- What are your time constraints in realizing your investment?
- Is there a demand for the product or service?
- What is the level of competition?
- Are there corporate-owned outlets?
- How reliable are the franchisor's earnings claims? Beware of unsubstantiated claims!
- What is the growth potential for the system?

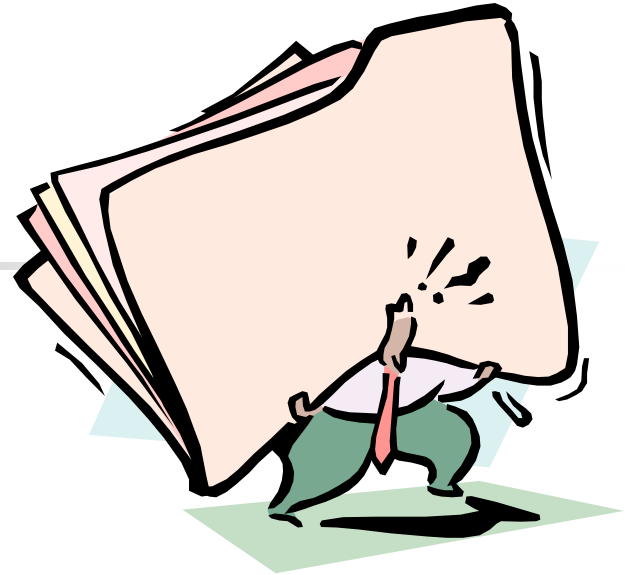


Before Buying a Franchise (3)

- Does the product or service have brand recognition?
- Does the franchisor exhibit a high degree of professionalism? (Avoid high pressure sales tactics)
- How experienced is the Franchisor?
- What kind of training and support services are offered by the Franchisor?
- Franchisee association in place?
- Number of terminations, transfers and non-renewals?

Legal Documents

- Buying existing or new?
- Offer to Purchase
- Franchise Agreement
 - Deposit and Confidentiality Agreement
 - Sublease or Lease
 - Guarantee
 - Software License Agreement
 - General Security Agreement
 - Co-branding Riders
- Disclosure Document





Franchise Agreement

- Most franchise agreements are NOT negotiable
- Onerous agreement in favour of ZOR
- Important Provisions
 - Trade-Mark (Well known?)
 - Territory (Exclusivity? Reserved rights?)
 - Term and Rights of Renewal
 - Obligations of Franchisor (if any)
 - Transfer and Termination

Fees Payable to Franchisor

- Initial Franchise Fee
- Renewal Fee
- Training Fees
- Royalties
- Advertising Contributions
- Transfer/Renewal fees
- Sub-leasing or leasing fees





Disclosure Document (1)

- Material Information necessary to make an informed decision
- Contains financial statements
- 14 Day Rule and consequences for failing to abide by the rule
 - Right of Rescission
 - Statutory right of Action/Misrepresentation



Disclosure Document (2)

- Material facts to be disclosed include the following:
 - Business background of the Franchisor, directors and officers etc.
 - Details regarding any convictions for fraud, unfair or deceptive business practices
 - Litigation history
 - Bankruptcy or insolvency
 - Franchisee's costs associated with the establishment of the System and operation of the franchise



Disclosure Document (3)

- If earnings projections are provided, a statement providing the reasonable basis for estimate
- Details regarding any financing arrangements offered by Franchisor
- Description of training and other assistance offered to Franchisees
- Description regarding the advertising fund



Disclosure Document (4)

- List of terminations and non-renewals
- Current and former franchisees ***
- Financial history & financial statements
- Other prescribed information

Disclosure Document - Advice

- Obtain a certificate of disclosure
- Resist pressure to quickly “close the deal”
- Seek legal advice to review disclosure document and franchise agreement
- Have accountant review financials
- Trust your instincts!





Potential Pitfalls (1)

- Obligations to purchase all product from franchisor
- Hidden fees
 - lease review, consulting, additional training, commissions on leases or bank financing, renovation requirements in franchise *and* lease agreements, % rent
- Burdensome restrictive covenants against competition after the term
- Harsh termination provisions: is good and reasonable cause required?



Potential Pitfalls (2)

- Overly stringent conditions on renewal or transfer (excessive renewal or transfer fees)
 - Mandatory release
 - Ability by Franchisor to deny transfer or renewal for even one or minor breach
- No assurance of geographical exclusivity or protection: encroachment
- Too many terminations or non-renewals
- Personal guarantee may be required



Potential Pitfalls (3)

- Criminal records or unfair or deceptive business practice convictions
- Directors have no franchising experience
- Too much litigation
- Financials that show that revenues are derived from franchise fees rather than from royalties
- Incomplete or inconsistent disclosure



One Final Note

- Buying a franchise: A significant financial decision
- Invest in retainer of professional counsel
- Disclaimer: This information is published for general information only and should not be construed as legal advice or opinion
- “Ask The Experts” (from 3:00 to 4:00 pm)
- For additional information...

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