

## **Legal Considerations for Prospective Franchisees**

This article has been provided by the law firm Osler, Hoskin & Harcourt LLP and examines some of the legal matters you should consider when investing in a franchise, and what you can expect to receive in return.

### **1. THE FRANCHISE SYSTEM**

A franchise system can take many forms but typically can be defined as *a license to use specific trade-marks and to operate a business under an established system according to uniform standards.*

For a franchised business to succeed, the franchise system must be inherently sound and managed by a knowledgeable franchisor. Additionally, a franchisee should possess an entrepreneurial spirit while being able to run his or her business in strict compliance with standards set by the franchisor. The key to any franchise system is uniformity; without it, the system would be nothing more than a collection of independent businesses with a common name. A franchise's customers expect consistency, regardless of where in the country (or even the world) they visit one of its locations. If you are considering investing in a franchise system, especially a relatively new one, you should:

- Visit a number of franchised locations to see how the franchises are operated.
- Talk to existing owners to see what their experiences have been
- Ask yourself whether you would be a customer of the business. If yes, what particular aspects of the business appeal to you? If not, why not?

### **2. TERMS AND CONDITIONS**

In exchange for initial franchise fees and ongoing royalty fees, the franchisor is licensing you to use its intellectual property and business system to establish and operate a franchised business for a specified term. Before entering into a franchise agreement, check the duration of the term and the conditions you must satisfy to exercise any renewal option. It is critical to understand that, upon the expiry of the term (including any renewals), you no longer have any right to operate the business. Accordingly, when discussing the prospective franchised business with your BMO Bank of Montreal financial advisor, consider whether the term is long enough to (a) recoup your initial investment, including the franchise fees and the cost of establishing the franchised business, and (b) earn a suitable profit (considering payment of ongoing fees and other costs of running the business).

Franchises may be operated at retail locations, or may be home-based businesses. Service franchises often conduct business at the customers' locations. Depending on the nature of your business, an investment in a fixed location, equipment and inventory may be required.

Some franchisors will construct and outfit your premises at your cost on a turn-key basis so that you need not be concerned about finding a location, equipping the business or hiring contractors – you simply begin operating the franchised business after training. Otherwise, the franchisor may simply assist you in selecting and developing your business premises. Many franchisors will provide mandatory standards and specifications for the construction and

development of your premises. Other franchisors prefer to give general guidelines and provide you with greater latitude in the design of your franchised business and training programs.

You must appreciate the full extent of all costs associated with the business, and the ability of the franchisor to require you to upgrade your business over time.

You must also understand whether you are being granted an exclusive territory, and whether the franchisor may compete with you in other locations or in other businesses.

### **3. TRADE-MARKS**

A good franchisor has invested substantial time and money to develop, register and protect the intellectual property portfolio relating to its franchise system. When you invest in this system, you will be granted the license to display the franchisor's trade-marks at your premises until the term of your agreement has ended. Should you sell your business (which usually requires the franchisor's consent), you are not selling the trade-marks or the goodwill associated with them.

### **4. SUPPORT**

While some franchisors offer franchisees little support beyond providing a regularly updated operating manual, most have toll-free support lines, site visits by local representatives, and mandatory initial and ongoing training or educational courses to help franchisees become familiar with systems and procedures required to operate the franchised business.

Many franchisors have regional and national advertising programs to which franchisees contribute a certain percentage of their revenues. Usually, the franchisors are responsible for operating the advertising program, including designing and placing the advertisements, allowing you to reap the benefit of the advertising program on a system-wide basis.

### **5. SUPPLYING PRODUCTS AND SERVICES**

In many franchise systems, the franchisor will also be your product supplier. In other systems, the franchisor will make arrangements with approved suppliers for the terms and conditions of product supply. In most systems you will not be permitted to use unapproved outside suppliers, at least not without the franchisor's approval. As a side note, it is not uncommon for a franchisor to receive rebates, concessions or other allowances from your purchase of goods and services, which the franchisor may retain for itself without sharing. Remember, the franchisor has spent considerable time and effort establishing these supply channels and negotiating prices. Your main concern is that you have the ability to be supplied on reasonable terms, including at competitive prices.

### **6. FRANCHISEE RIGHTS UNDER LAW**

There are many federal and provincial laws that apply to franchising. Currently, Ontario, Alberta, and Prince Edward Island (P.E.I.) have implemented franchise-specific legislation. New Brunswick (N.B.) has passed similar legislation which is expected to be implemented shortly. Under these laws, a franchisor must deliver a disclosure document to a prospective franchisee in Ontario, Alberta or P.E.I. (and eventually N.B.) within a specified time. Generally, a disclosure document must be delivered at least 14 days before the franchisee pays any consideration or signs any agreement relating to the franchise. The disclosure document must adhere to prescribed format and content requirements. The document is not reviewed by any

governing body, but the legislation prescribes a right of rescission and penalties for non-compliance and misrepresentation. Franchise legislation also imposes a duty of fair dealing on the franchisor and franchisee in the performance and enforcement of a franchise agreement. Fair dealing includes the duty to act in good faith, and in accordance with reasonable commercial standards. Additionally, franchisees have an unrestricted right to associate and organise under franchise law. A franchisee's rights and a franchisor's obligations under franchise legislation cannot be waived.

## **7. FRANCHISE-RELATED DOCUMENTS**

Besides receiving a disclosure document (in a disclosure province), you will also be required to sign a number of agreements. The most important agreement is the franchise agreement which sets out all of the fundamental terms and conditions. If you incorporate a company to operate the franchise, you will likely be required to sign a personal guarantee. If the location of the business is leased, you will have to sign a lease with the landlord, or a sub-lease with the franchisor if the franchisor leases the premises. You may have to sign a computer software license for point-of-sale or reporting systems, or a reservations services agreement if the franchised business includes a reservations or central booking service. Many franchisors also require their franchisees to execute general security agreements under which they give security interests to their franchisor as collateral for any amounts payable under the franchise agreement.

When reviewing the franchise agreement, disclosure document (if applicable), and any ancillary agreements, it is strongly recommended that you retain an experienced franchise lawyer to ensure that you understand your obligations, and that your rights are protected and enforced.

## **8. SUMMARY**

As a franchisee, you'll operate a business using systems tried and tested by the franchisor. You're buying a licence to be part of an established system. You are relying on the reputation of the franchisor, and the public recognition of its trade-marks, to attract customers. In return for your investment, you will receive training and assistance in establishing and operating your franchised business, and the right to operate your business for a specified term to achieve a return on your investment. Once you've made the decision to invest in a franchise, all that remains is to choose your new franchise, understand the legal implications, sign the documents, and start operating.

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