

# **Multi-Unit and Multi-Brand: The New Trend in Franchising**

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## 1. Introduction

The traditional model of a franchise system with a single-franchisor and single-unit franchisees is by no means extinct; however, franchise systems are increasingly taking on alternative models in order to leverage the advantages of the franchise business model and expand more efficiently, expeditiously, and effectively. Generally described as “multi-unit” and “multi-brand” franchising, these arrangements can be advantageous to franchisors and franchisees in many respects. However, breaking from the traditional model does pose its own set of challenges that franchisors and franchisees must be cognizant of and address appropriately. By utilising these forms of franchising structures, the traditional franchisor-franchisee relationship is altered. As a consequence, the legal framework governing the relationship should be structured in a manner that reflects the arrangement and safeguards against the potential issues that may arise. This paper intends to address the advantages and unique considerations that arise in the contexts of multi-unit and multi-brand franchises and will demonstrate how effective drafting of the relevant agreements can facilitate successful operations.

*When done properly, the concept of Multi-Unit franchise partners is truly win-win. It is a partnership that guarantees speed to market, operational efficiencies and a consistent client experience in geographies with multiple locations in close proximity. Furthermore, the franchise partner can aggressively grow in a system in which they are familiar, and the franchisor can aggressively grow with a partner with whom they are familiar – Fraser Clarke*

*As barriers to entry continue to fall for new franchisors and the emerging franchisor space becomes increasingly crowded, Multi-Brand “platform” companies represent a growing trend. These Franchisors enjoy many competitive advantages that are harder for smaller independent brands to capitalize on including scale, centralization and cross brand synergies – Dan Monaghan*

### (a) **Multi-Unit Franchising**

Multi-unit franchising can occur in two contexts, the first being when it is contemplated that the franchisee will operate more than one unit from the outset of the relationship. This is established most commonly through an area development arrangement or a master franchise

arrangement. Area development deals typically involves one franchisor and one franchisee. The franchisee is tasked with growing the franchisor's brand within a defined territory by opening and operating multiple franchise locations in the specific area. The agreement that the parties enter into will include, among other provisions, performance objectives and a development schedule, which obligates the franchisee-developer to meet specific benchmarks over the term of the agreement. A master franchising agreement is similar to the area development agreement in that the franchisor gives the responsibility of developing a defined territory to the franchisee. However, an area development agreement typically does not give the franchisee the right to sub-franchise to third parties, while the master franchise agreement does include that right. This means that the master franchisee may not ultimately operate every unit in the territory and the franchisor-franchisee relationship for a particular franchise unit may involve three independent parties.

Multi-unit franchising may also arise where a single-unit franchisee decides to acquire the rights to establish and operate more franchise units. If both the franchisor and franchisee are satisfied with the operation of the current single-unit arrangement and find it beneficial to continue to expand, the franchisor will enter into an arrangement with the franchisee to operate additional franchise units. In each context, the issues of cost efficiencies, the obligations of each party, and the franchisee's capacity to accommodate increased responsibilities will be raised.

(b) ***Multi-Brand Franchising***

The multi-brand model arises in two distinct contexts. The first is when the franchisor owns more than one brand or franchise system – referred to in this paper as a “multi-brand franchisor.” The franchisor may wish to operate these brands or franchise systems exclusive of one another, or there may be a benefit to establishing a connection between the brands and openly communicating this association to the relevant market. The second context is where the franchisee operates multiple franchise units from different brands or franchise systems that are owned by independent (and unrelated) franchisors – referred to in this paper as “multi-brand franchisees”. In each case, the issues of competition, capacity to accommodate multiple systems, and the potential implications of brand association are important factors for the parties to consider.

## 2. The Benefits of Multi-Unit and Multi-Brand Franchising

### (a) *Multi-Unit: Benefits for the Franchisor*

Having a single franchisee operate multiple franchise units is advantageous to the franchisor in many respects. Among these benefits are the efficiencies that result from consolidating control over the same number of units into the hands of fewer franchisees. The franchisor's transaction costs (and ongoing costs) are reduced by dealing with the same franchisee to establish and operate multiple units, compared to dealing with multiple franchisees for the same number of units.

In a master franchise arrangement, the franchisor realizes further benefits by virtue of the franchisee having the right to sub-franchise. In these relationships, the franchisor has an added degree of separation from the establishment and operation of a new franchise unit. When the master franchisee is given the ability to sub-franchise, the franchisor's burden of overseeing the franchise is delegated to the master franchisee, resulting in lower associated costs and expended effort for the franchisor. It should be apparent that striking the right balance vis-a-vis dividing obligations (and associated costs and profit) is not a straightforward exercise, and franchisors ought to be wary of relinquishing too much control to the master franchisees. Despite the benefits of delegating the responsibility to secure new franchise units to another entity, a franchisor will still want to maintain an adequate measure of control over the franchise unit to ensure that the franchisor's expectations of brand quality are upheld.

The franchisee that engages in multi-unit development is, itself, an asset to the franchisor. A franchisee that is seeking a multi-unit deal is likely to be well-financed and have some experience in the industry. A franchisee's deep pockets and prior experience running a franchise will benefit the franchisor by reducing the risk associated with opening a new franchise unit. A sophisticated franchisee may be less likely to suffer the pitfalls a new franchisee may fall victim to. This know-how can also decrease the franchisor's obligation to provide ongoing support as the new franchise unit begins operating.

From a strategy standpoint, multi-unit arrangements can benefit the franchisor as it looks to expand into new markets. Whether it is a franchise based in one province and looking to

expand elsewhere in Canada, or a franchise looking to expand to another country, there are particularities that need to be considered in each new market. A multi-unit franchisee can facilitate a smooth transition if the franchisee is better equipped to understand the market's characteristics, such as language, cultural, political and legal differences. A franchisee familiar with the new territory will add value to the franchisor's expansion when it comes to navigating these important considerations.

(b) ***Multi-Unit: Benefits to a Franchisee***

A franchisee operating more than one franchise unit often finds that it can benefit from economies of scale and from efficiencies that can be realized from the arrangement. Certain operational costs and systems, such as supplies, distribution systems and IT systems, can be shared amongst all of the franchise units, increasing profitability on a per unit basis.

In addition to the ability to distribute resources and expenses over several operating units, the franchisee also distributes the risk associated with operating within a franchise system over several units. The impact of an underperforming location on the franchisee is dampened when it is only one of many within its own franchisee network.

The franchisee also has the advantage of increased bargaining power as it becomes heavily relied on by the franchisor. The franchisee's role is integral to the success of the franchisor in a larger territory, rather than just the success of a single franchise unit. This heightened reliance gives the franchisee significant leverage and it can use this position to bargain at the outset with greater authority. If the franchisee has prior experience operating a franchise and a track record of success, this will bolster its bargaining power. As a result, the franchisee may be able to negotiate an increased level of autonomy and better terms for itself (clearly, within the bounds of the franchise system framework), compared to the single unit franchisee.

(c) ***Multi-Brand Franchisee: Benefits to the Franchisor***

Similar to the multi-unit context, a franchisee that is engaged in multi-brand franchising can be an asset to the franchisor. The franchisee offers the experience of already having operated one or more franchise units, albeit under other brands. The franchisee likely would have had

success operating these other brands if it is seeking to establish and operate additional franchise system units. The franchisor can take comfort in the fact that its new operator has a proven track record of success and the franchisee can bring tried and tested operation management into the franchisor's system. Similar to the multi-unit scenario, the franchisor would then benefit from the franchisee's diminished reliance on the franchisor to support its operations.

The franchisor may also have an advantage if the franchisee operates another brand that compliments the franchisor's. There may be an association in the market or the potential for co-branding that could be used to benefit the franchisor's brand. It may also lead to broader system-wide cooperation between brands, or further still, meaningful mergers and acquisitions. As will be discussed, brand association can be detrimental and the franchisor will want to ensure that any connection between brands is made and managed under its control and not at the whim of the franchisee.

(d) ***Multi-Brand Franchisee: Benefits to the Franchisee***

This multi-brand context can arise where a franchisee has been successful in franchising with one brand and reached the limit of its opportunities with that brand. Perhaps because the franchisee's existing franchisor has sold all of its territories, the franchisee may wish to continue expanding its portfolio of franchise units. Operating under another franchise system will provide opportunities for further expansion.

A franchisee may also be looking to operate within another franchise system in order to diversify its position with a greater range of product or service offerings, thereby spreading its risk across not only different franchise units but across different systems, and possibly different industries. By having various product and service offerings, the multi-brand franchisee is not as reliant on a single brand and its market performance. The franchisee operating multiple brands has the added value of being able to realize profits by reaching consumers through diverse channels.

The franchisor in this scenario can also benefit in a similar fashion to the multi-unit franchisor. If the franchisee has established successful operating systems under one brand, it may be able to effectively apply certain aspects of its operations to any additional franchises that it

begins to operate (subject to the restraints under the franchise agreements). The ability to share resources and spread expenses across multiple operations can increase the profits realized by the franchisee on a per unit basis. As will be discussed later, potential issues may arise if the new brand that the franchisee is looking to operate under is a market competitor with the original brand.

(e) ***Multi-Brand Franchisor: Benefits to the Franchisor***

A franchisor that owns more than one brand has the advantage of being able to compete either across industries or under different brands within the same industry. In each case, the franchisor has diversified interests and is able to offer a range of products and services that is greater than is realized under one brand. This diversification will naturally lead to potential synergies and increased potential for sales and profit. The franchisor open to multi-brand franchising will also be in a better position to respond to market trends and flux in consumer demand by providing products and services that align with these changes.

The franchisor can benefit in many of the same ways that a multi-unit franchisee benefits. The resources that the franchisor utilizes in one brand can, if compatible, be used for the other brands. Human capital (management, employees, etc.) can be shared, the same supply chain may be better leveraged, and any internal and external system requirements can be made common across all of the franchisor's brands (i.e. customer and IT support). Not only can operational systems be duplicated or centralized between multiple brands, but the brands themselves can be used to advance one another. Cross-marketing and cross-promotion efforts can draw new customers to one brand based on the strength of another brand's reputation.

(f) ***Multi-Brand Franchisor: Benefits to the Franchisee***

At the franchisee level, the advantages of a franchisor who owns multiple brands are an extension of the franchisor's own benefits. The franchisee can realize lowered operational costs based on any opportunities the franchisee has to share expenses between the brands. As has been discussed, when possible, centralized operational systems may be used by all of the brands under the franchisor's control. Employees may be able to split time between the brands and if the brands are fast-food restaurants, for example, supplies that are common to each can be bought

for all of the restaurants. If the franchisor has a program that includes establishments and operations of combined franchise units, additional opportunities to share resources and optimize profitability present themselves. When the brands are complimentary, a single location can host the consumer activity of multiple brands, multiplying the profitability of the location in comparison to a single-brand unit. Furthermore, expenses like maintenance costs for the location can be split between the brands, as opposed to being borne by one. Unlike multiple units of one brand, multiple brands will not have everything in common and the franchisor will want to maintain a certain level of distinction in the mind of consumers. However, the franchisee will still be able to find ways to take advantage of any commonalities that do exist and are permitted by the franchisor.

As was discussed in the benefits for a franchisor, complimentary brands can be utilized to boost the sales of one another. This connection does not need to be as extensive as operating different brands in the same location. Creating association among brands in the public perception can be realized by other marketing and promotional activities. When successful, the franchisee will have the opportunity to sell or offer services to a customer base that the single brand may not have had access to alone.

Finally, the franchisee benefits from the ability to choose which brand offering it would like to operate. A multi-brand franchisor is able to display a wide range of brands that the franchisee can choose from based on its own considerations. A franchisor in the hotel industry may have a high-end, luxury brand that is offered at a very high price point but the same franchisor may have additional brands of hotels that are offered at different price points, targeting different market segments, each with their own unique characteristics. When presented with the different possibilities, the franchisee can evaluate which brand best suits its own objectives as an owner-operator.

### **3. Multi-Unit and Multi-Brand: What Could Go Wrong?**

Having discussed the benefits of the multi-unit and multi-brand models to franchisors and franchisees, the discussion must move on to the potential issues that franchisors and franchisees may experience attempting to realize these benefits. These issues may be inherent to the

operation of a multi-unit or multi-brand franchise system, or may arise by way of the parties' miscalculated pursuit of franchising on a greater scale.

(a) ***Multi-Unit: Negatives for the Franchisor***

A key consideration for the franchisor in a multi-unit arrangement is the issue of scale, influence, and ultimate bargaining power of the franchisee. By giving the franchisee the authority to operate a significant number of units, control is shifted to a franchisee and the franchisor-franchisee relationship can be substantially altered. Compared to a single-unit franchisee, the multi-unit franchisee has significantly more leverage and bargaining power. By alleviating the need to set-up new franchise units incrementally with individual franchisees, the franchisor is increasingly reliant on the multi-unit franchisee to successfully develop the territory they have been assigned. The franchisor also assumes the risk that a lacklustre franchisee may taint multiple locations.

Depending on the size of the franchisor, the relative economic value of a multi-unit franchisee may become equal to, or even surpass, the value of the franchisor. The sophisticated franchisee with previous successes in franchise development will recognize the value that it adds to a franchise system and use this to its advantage. The franchisee also has a significantly higher level of investment committed to the development plan and spends much more in management and operational costs than the single-unit operator. The dynamic between the two parties may feel this added stress. The relationship between the franchisor and multi-unit franchisee will need to be governed effectively to ensure a strong, collaborative approach is taken to grow the brand.

Another setback presents itself when a multi-unit franchisee is underperforming. The risk of relying on one franchisee (i.e. lack of diversification) to develop a significant territory materializes when the franchisee underperforms and the franchisor's objective of establishing units efficiently, expeditiously, and effectively throughout the region is not realized. When a franchisee has been granted the exclusive right to develop the territory, the franchisor may have less flexibility to respond and make appropriate changes to correct the shortcomings of the franchisee.

This is not limited to instances of underperformance. If a territory granted to a multi-unit franchisee is found to have a greater capacity for franchise units than initially estimated, the franchisor is again faced with the difficulty of adjusting its strategy to meet an increased demand. The franchisor's actions can have much farther reaching consequences than tackling encroachment issues with a single-unit franchisee. Can the franchisee accommodate the franchisor's desire to increase the rate of development, or will it be amenable to relinquishing a portion of its exclusive territory? In addition to conceding bargaining power, the franchisor has potentially conceded agility to respond to market changes.

(b) ***Multi-Unit: Negatives for the Franchisee***

Naturally, the consequence of operating on a greater scale is the increase in the franchisee's overall operational costs. As discussed with the benefits to the multi-unit franchisee, efficiencies can be created by utilizing systems across various units where possible. However, certain functions may not be adjustable in a manner that can serve all of the operating units. Additional layers of management will be required to oversee day-to-day operations at all of the franchise units and overhead costs that cannot be shared among the franchise units will increase. For the potential multi-unit franchisee that is a large and powerful entity and that is pursuing a multi-unit deal from the outset, this will likely come as no surprise. However, the franchisee that began as a single unit operator and seeks to expand through a multi-unit arrangement should consider the level of additional expenses it has the capacity to take on.

In addition to the inherent costs associated with operating on a greater scale, the franchisor's expectations from the franchisee will also be greater. The franchisor benefits from the multi-franchisee's experience, which may alleviate some of the responsibilities that would be reserved for the franchisor in a single-unit context. If that is the expectation at the outset of the franchisor-franchisee relationship, the franchisor may look to obligate the franchisee to share in the operational support costs that the franchisor would normally bear alone. The franchisee should undertake an honest assessment of its capacity to take on the additional responsibilities required as an operator of multiple units.

(c) ***Multi-Brand Franchisee: Negatives for the Franchisor***

While the franchisee will look to benefit from operating multiple brands, the franchisor must be vigilant in guarding its own brand from potential negative impacts from the other brands the franchisee is engaged with, or from the franchisee itself.

Trade secrets and confidential information will necessarily be shared with the franchisee to effectively operate under the franchisor's brand. A concern arises when the franchisee looks for opportunities to advance its operations by drawing on the best aspects of each of the franchise systems that it is operating under. There may be particular functions of the franchise system that the franchisor wants to keep "in-house." This is of particular concern where the franchisee operates other brands that are competitors to the franchisor. In that case, when the franchisee is applying the skills, methods and characteristics of one franchise system to its operations of other brands, the franchisor's trade secrets and confidential information may inadvertently be used to advance competitors with no benefit received in return.

In addition to separating its operations, the franchisor may wish to have its brand strictly presented to consumers and in a manner completely distinct from the franchisee's other brands. The franchisee may look to leverage an association between the brands that it operates. Such benefits were previously discussed, but both the franchisor and franchisee should be mindful of the downsides connected with brand association. Any negative attention or consumer reaction directed at one brand may spill over and negatively affect associated brands. A franchisor may be willing to take on this risk when it is a brand association that it has control over. However, when the association is merely a result of the franchisee's engagement with another franchise system, the franchisor ought to consider the potential negative impact that can occur if the other brand were to develop a negative reputation in the mind of consumers.

(d) ***Multi-Brand Franchisee: Negatives for the Franchisee***

The franchisee must be cautious of overextending itself to the point where its obligations under its respective franchise agreements cannot be met. Of particular importance is the covenant to devote "full time and attention" to the franchise. The franchisee may be under a multi-unit agreement that requires a development schedule and performance benchmarks to be met. Will the franchisee be able to fulfill these and other positive obligations under each of its franchise agreements or will dividing its time between franchise systems cause it to default?

Given the negatives to the franchisor, the franchisee may be subject to franchise agreements that include restrictive provisions that protect the franchisor from some of the negative aspects of a multi-brand franchisee. The franchisee may have restrictions on its method of operate, particularly if it were to begin operating franchise units that are in competition with one another. If the franchise agreement contains a non-compete clause, the franchisee may be contravening that agreement by operating a competing franchise unit. Franchisees should refer to any franchise agreements that it is currently subject to and determine if these explicitly provide that it cannot engage with a competing franchise system or restrict its ability to operate its franchise units in any way.

(e) ***Multi-Brand Franchisor: Negatives for the Franchisor***

The acquisition or development of additional brands may result in negative implications for the franchisor. As has been discussed, the risk of creating an association between brands in the mind of consumers is the threat of one brand's reputation being tarnished which may, by association, adversely affects the other brands.

Another risk, and one that has been discussed in all of the contexts considered, is the potential for franchisors to expand beyond its means. While efficiencies can be realized that disperse costs across the brands, the fact remains that managing multiple brands will require additional resources. Is the franchisor capable of implementing the necessary level of support to all of its brands in order to facilitate growth in each? The obligations to franchisees, under its franchise agreements, needs to be considered. By spreading itself across multiple brands, the franchisor may now be open to claims from franchisees for not providing an adequate level of support and its franchisees may look for recourse against the franchisor for not focusing on one specific franchise system.

Franchisors may also encounter restrictions on the business decisions it wishes to implement. The franchisor may wish to allocate more of its resources to one brand that is performing particularly well. However, this may cause issues with its other franchisees, who consequently receive less resources. Does this allocation serve as a detriment to the franchisees of the other brands that could bring about legal action? In a scenario where the franchisor has acquired an established franchise system, were there any restrictions imposed by the seller in the

acquisition? The franchisor may wish to absorb its brands under one name or change the acquired franchise system in some other manner that has been restricted through the acquisition. This is a key consideration for the franchisor, as its ability to manage each brand may be limited in some respect.

Finally, multiple product or service offerings under different brands was considered an asset earlier by giving the franchisor the flexibility to respond to changing consumer demands. However, maintaining a range of products or services could also detriment the franchisor. With multiple brands competing in the same market, brands may draw sales from one another and market cannibalization may occur. The franchisor's capacity to take on an additional brand has already been considered, but the market's capacity for another competitor should also be considered. The franchisor should assess if another brand will generate enough consumer activity to be worthwhile. The franchisor should be wary of adverse effects on sales if a new brand is introduced in the same market that the franchisor already competes in.

(f) ***Multi-Brand Franchisor: Negatives for the Franchisee***

If the franchisee operates under a multi-brand franchisor, any negative effects that the franchisor experiences will inevitably be passed down to the franchisee. A franchisor that has expanded beyond its capacity will not be able to devote adequate resources to each brand under its purview. By extension, at the franchise unit level, each individual unit will not have the same level of support that would have been available from a single-brand franchisor. In the multi-unit context, consideration was given to the notion that the franchisee may be experienced and sophisticated enough to navigate operations without much support. In the multi-brand franchisor context, single-unit franchisees are likely to rely more heavily on the franchisor for support. Will these franchisees be given adequate support from the franchisor?

Finally, the potential negative effects that the brands have on each other will be felt at the operations level. Any negative consumer reputation or market cannibalization will decrease sales. The franchise unit itself will generate less activity if the franchisor's other brand has experienced garnered a negative reputation or if the franchisor introduces a competing brand, taking customers away from the franchise unit. The franchisee is the first to feel these negative effects.

If the franchisor introduces a competing brand to the market, the franchisor should foresee that it will draw sales away from another brand. The franchisor likely will have a tolerance for the negative effects the new competitor will have on the other brands. Decreased sales experienced by one brand may be balanced by the sales of the franchisor's new brand. On the other hand, the franchisee is directly affected by this decision, which is beyond its control, and it will not be able to balance sales if it operates the brand that is negatively affected.

#### **4. Private Equity and Multi-Unit and Multi-Brand Franchising**

In an increasingly significant way, private equity firms are recognizing the advantages outlined above and are increasingly becoming players in the franchise sector. Private equity franchisees certainly have the characteristics of a franchisee that would serve as an asset to the franchisor. These franchisees have the sophistication that a franchisor is looking for to positively impact its franchise system. The private equity franchisee has a vast network of resources and connections through its other endeavours that can be utilized in operating franchises, whether it is potential suppliers or its existing management that can be deployed to run the operations.

Another aspect of the private equity firm that may turn into a point of contention is the bargaining power that it will have, as well as its sole focus on creating profit for its investors. This combination may cause stress on the franchisor-franchisee relationship when there are decisions to be made regarding the direction of the franchise as a whole. The private equity franchisee will have valuable opinions on the brand's strategy, with a focus on profitability. However, the franchisor may take other factors into consideration when evaluating a strategy and issues may arise if the franchisor is presented with multiple directions to pursue and chooses against the private equity firm's preference.

In short, a private equity franchisee has all of the characteristics to benefit a franchise system that were discussed earlier. However, the franchisor-franchisee relationship may become acrimonious due to the private equity firm's influence and sole objective of maximizing investor returns.

## 5. Multi-Unit: Contract Drafting Points to Consider

In any franchisor-franchisee relationship, the franchisee is reliant on the franchisor to support its operations. In particular, the multi-unit model amplifies reliance on a single franchisee. It has been established that the challenges that each of the franchisor and franchisee face will have an impact on the other party. How can each party protect itself from the problems that may arise? Both the franchisor and franchisee have significant benefits to gain and increased levels of investment at stake. The success of the relationship is in the best interest of both parties, making the need for a comprehensive strategy with legal safeguards in the event something does go awry, all the more important.

### (a) *Exclusivity Territorial Rights*

Along with a multi-unit agreement comes the expectation from the franchisee that it will be granted the exclusive right to offer the franchise's goods and services within a particular geographic area (albeit through establishing and operating more than one unit). The franchisee will negotiate to have as broad of a territory as possible; however, as has been a theme of the discussion so far, the franchisor should be wary of the franchisee taking on more than it can handle and should refrain from granting exclusivity over too large of a territory. If the territory is too large, a single franchisee may not be able to keep pace with unit development across the area, leaving the franchisor with an underdeveloped region.

Limiting the franchisee's territorial exclusivity is in the best interest of both the franchisor and franchisee as it ensures that the franchisee is not overextending itself and at risk of failing to meet its development obligations. This limitation can also temper the franchisee's bargaining power. If a large territory has one powerful franchisee, the franchisor must necessarily concede a considerable amount of its bargaining power, as opposed to having a few multi-unit franchisees dispersed throughout the region.

The franchise agreement may provide that the territory is fixed or variable. The variation of the boundary may be dependent on particular market factors or it may simply be a clause that establishes that the boundary will be renegotiated at a later date. The franchisee may be satisfied to take a smaller exclusive territory at the outset, with the promise of expansion if specified

benchmarks are met. It is advantageous for the franchisor to negotiate for a smaller defined territory to strike a balance between the advantages of dealing with less franchisees and the drawbacks of becoming too reliant on a single franchisee.

The franchisor would be prudent to ensure that the territorial exclusivity granted will not inhibit its own ability to conduct alternative business activities in the territory. There may be particular instances where the franchisor would want to offer its goods and services within the defined territory (i.e. through other distribution channels). To address this concern, the agreement should contemplate the reservation of certain rights in favour of the franchisor. If a customer within the territory has an account that reaches beyond the defined boundaries, the franchisor may wish to reserve the right to deal with this particular customer. The franchisor should consider and provide in the agreement the instances in which it would limit the franchisee's exclusivity and reserve the right to sell under the brand's marks for itself.

(b) ***Establishing Franchisee Performance Benchmarks and Enforcing Defaults***

Careful consideration should be given to development schedules and other expansion obligations, as well as the terms and conditions employed to map the development of the territory along the way. At the outset of this paper, it was established that, when executed correctly, the multi-unit arrangement can be advantageous to both the franchisee and the franchisor. However, the franchisor's desire to expand its brand quickly needs to be tempered by providing realistic and attainable performance requirements.

Whether these obligations are met or not, the relevant agreement needs to contemplate what happens next. If the franchisee falls short of its obligations, the franchisor will want a broad range of rights available to exercise. The agreement could provide for the franchisor's right to fully terminate the agreement. The franchisor may want the franchisee to continue to operate its existing units, but upon default, the franchisor has the option to transfer some or all of the development rights to another franchisee. In that case, the defaulting franchisee would carry on as a non-exclusive franchisee. Another method, more advantageous to the franchisee, is providing the franchisee the opportunity to sell the development rights. The franchisor can maintain some control over the sale of the development rights by retaining a right of first refusal on the sale (which is in itself another possible remedy where a franchisee defaults on its

obligations.) The franchisor should consider providing alternatives to terminating the agreement if the arrangement with the franchisee has proven to be successful apart from the triggering default.

(c) ***Maintaining Franchisor Influence on the Franchise Unit***

The franchisor may be relying on the franchisee's experience to develop in a particular region or country, however, it may still be a new relationship and the franchisee may not have experience operating the franchisor's specific system. The franchisor may wish to retain final approval over certain decisions until the franchisee has demonstrated that its previous experience and success transfers to operating within the franchisor's system.

A key component of franchise development is the location of a franchise unit. Before delegating the entire decision-making process to the franchisee, the franchisor may look to protect itself from the possibility that the franchisee is not equipped to make effective location selections. The franchisor can exhibit some control over the process by maintaining the right to have final approval of a unit's location and a right to review the location's details against its own location selection criteria.

When considering how the franchise units will operate, the franchisor may want to retain some measure of control over the system's suppliers for quality assurance purposes. The franchisee is motivated to capitalize on all of the efficiencies that were discussed earlier to the fullest extent possible. If there are supply agreements, other than the franchisor's preference that will maximize profit on a per unit basis, the multi-unit franchisee will naturally want to pursue these other arrangements. The franchisor may wish to restrict a franchisee's autonomy over the selection of its suppliers to ensure that the supplies the franchisee uses are consistent with system standards. This can be done by limiting the selection of suppliers to a list of approved vendors or setting out that the selection process is subject to approval based on a defined set of criteria. This issue ought to be contemplated and negotiated in advance of executing an agreement between the parties.

In a similar fashion, the franchisor may look to maintain high-level oversight in other areas of operations. This can be contemplated in the franchise agreement by specifying the

operations and management standards that each franchise unit must adhere to. All of these efforts have the goal of ensuring that while passing over some autonomy to the multi-unit franchisee, the franchisor does not become a passive spectator and can still direct its brand according to its vision.

## **6. Multi-Brand Franchisee: Contract Drafting Points to Consider**

Many of the potential negative implications on the franchisor in the multi-brand franchisee model can be addressed by restrictive covenants against the franchisee. Utilizing trade secrets and confidential information across different brands (even inadvertently) can be a negative consequence of the arrangement. Confidentiality agreements can act as a deterrent, however, it may be difficult to safeguard against general concepts and ideas that bolster the other brand (in a way that wouldn't occur if the franchisee didn't operate both brands.)

The franchisee will need to ensure that it is permitted to engage with more than one brand before it goes ahead and does so. Typically, the franchisee will likely be under a duty to provide its full time and attention to each franchise under the agreement. Will engaging with another franchisor put the franchisee into default? Other than the "full time and attention" clause, will a default occur based on another provision? If multi-brand operations is the franchisee's goal, it will need to negotiate multiple carve outs under its franchise agreements.

## **7. Multi-Brand Franchisor: Contract Drafting Points to Consider**

The franchisor that acquires or develops multiple brands should safeguard against any potential claims made by its existing franchisees. As discussed, the franchisee in the context of a multi-brand franchise may be dissatisfied with the franchisor splitting its time and resources between brands, especially if the franchisee operates within only one of the franchisor's systems and gets the sense that more effort is being diverted towards other brands. In such circumstances, the franchisee may bring a claim based on the inattentiveness (in human capital, investment and more) of the franchisor. Franchisors looking to operate multiple systems will need to draft robust provisions into their franchise agreements explicitly addressing this and other issues. By setting out that it does not owe its complete effort to any one brand, the franchisor can protect itself from claims of that nature.

Another consideration is the allocation of fees that each franchisee will make to the franchisor. It may be prudent to clearly define that fees paid by franchisees under one brand may only be used to fund the marketing, training and other support systems offered by the franchisor for that franchisee's brand. Keeping the funds segregated may cause an administrative burden; however, a potential issue arises when the franchisor looks to benefit from multiple brands by comingling expenses and operational support across all of its brand offerings. Clearly, a franchisee will take issue when a portion of its fees goes toward funding the activities of a different brand from which it will likely never realize any benefits from. The franchisor should consider how it would like to administrate franchise fees and give itself enough flexibility in the agreement.

Finally, the franchise disclosure document is an important consideration when discussing the context of a multi-brand franchisor. Due to the layers of complexity that are added by a franchisor owning multiple brands, compiling the disclosure of all of the brands into one document may lead to a convoluted document that is not adequate to present to franchisees. However, if the disclosure document is drafted with clarity, a multi-brand disclosure document may be a great resource for multi-brand franchisors who can present the relevant information for all of its brands available to a potential franchisee, while being able to satisfy its legal requirement to provide disclosure.

## **8. Conclusion**

In conclusion, multi-unit and multi-brand franchising arrangements are increasingly adopted by franchisors due to the enhanced benefits, including the increased scaling of operations to both franchisors and franchisees. In both contexts, the franchisee's experience is an asset to the franchisor and the opportunity to spread operational costs and risk across either multiple units or multiple brands benefits both parties by creating an efficient and profitable franchise system. Caution should be taken by each party to not extend itself beyond its capacity and each should consider and plan for any potential negative implications of the altered franchisor-franchisee relationship. Careful drafting of the franchise documents can help guard against the potential downfalls associated with these arrangements.