

**The 18<sup>th</sup> Annual Franchise Law Conference**

**Modernizing the Franchise Agreement to  
Address Business and Legal Realities**

Michael Melvin, McInnes Cooper  
Andrae Marrocco, McMillan LLP

November 13, 2018

Ontario Bar Association  
Continuing Professional Development

## **Modernizing the Franchise Agreement to Address Business and Legal Realities**

Franchising, like other areas of business, is constantly evolving. It is subject to the influence of technological advancements and to social and political changes. Moreover, ongoing developments in franchise law periodically change the legal landscape for franchisors in unpredictable ways. These changes sometimes necessitate clarification, customization and other changes to contract language and even modifications to franchisors' business practices. Given the continuous evolution of franchise practices in response to these pressures, regular updating and modernization of franchise agreements must be an ongoing priority for franchisors.

This paper provides an overview of the current drafting landscape for lawyers preparing franchise agreements and discusses seven (7) key areas in which many franchise agreements require upgrading or modernization in order to properly protect and serve the interests of franchisors. The eight specific drafting issues covered are: (i) drafting for *Raibex*; (ii) drafting to reflect modern technology; (iii) new approaches to territorial and exclusivity rights; (iv) supplies and authorized supplier provisions; (v) system changes and modifications; (vi) common employer issues; and (vii) renewal, transfer and termination rights.

### **The Drafting Landscape**

There are three main factors that define the drafting landscape for franchise agreements: the franchisor's duty good faith and fair dealing, the *contra proferentum* doctrine and ongoing developments in franchise law.

#### *The Duty of Good Faith and Fair Dealing*

The franchisor's duty of good faith exists at common law and serves to moderate the imbalance of power that exists between franchisor and franchisee in the typical franchise relationship.<sup>1</sup> It is codified in franchise legislation as the duty of fair dealing<sup>2</sup>. The statutory duty of fair dealing includes the obligation to act "in good faith and in accordance with reasonable commercial standards"<sup>3</sup>. It applies to the performance and enforcement of the Franchise Agreement<sup>4</sup> and, in most of the provinces that regulate franchising, it is also expressly stated to apply to the "exercise of a right" under the franchise agreement.<sup>5</sup>

---

<sup>1</sup> *Shelanu Inc. v. Print Three Franchising Corp.*, 2003 CarswellOnt 2038 (CA) at para. 66

<sup>2</sup> *Spina v. Shoppers Drug Mart Inc.*, 2012 ONSC 5563, [2012] O.J. No. 4659 (Ont. S.C.J.) at para. 146; *Landsbridge Auto Corp. v. Midas Canada Inc.* (2009), 73 C.P.C. (6th) 10 (Ont. S.C.J.) at para. 24; *Machias v. Mr. Submarine Ltd.* (2002), 24 B.L.R. (3d) 228 (Ont. S.C.J.) at para. 114; *1117304 Ontario Inc. v. Cara Operations Ltd.* (2008), 54 B.L.R. (4th) 244 (Ont. S.C.J.) at para. 66; *Fairview Donut, infra*, at para. 495.

<sup>3</sup> *Franchises Act* (Prince Edward Island), s. 3(3); *Franchises Act* (New Brunswick), s. 3(3); *Arthur Wishart Act (Franchise Disclosure)*, 2000 (Ontario), s. 3(3); *The Franchises Act* (Manitoba), s. 3(3); *Franchises Act* (Alberta), s. 3(3); *Franchises Act* (British Columbia), s. 3(3).

<sup>4</sup> *Franchises Act* (Prince Edward Island), s. 3(1); *Franchises Act* (New Brunswick), s. 3(1); *Arthur Wishart Act (Franchise Disclosure)*, 2000 (Ontario), s. 3(1); *The Franchises Act* (Manitoba), s. 3(1); *Franchises Act* (Alberta), s. 3(1); *Franchises Act* (British Columbia), s. 3(1).

<sup>5</sup> *Franchises Act* (Prince Edward Island), s. 3(1); *Franchises Act* (New Brunswick), s. 3(3)(b); *The Franchises Act* (Manitoba), s. 3(3)(b); *Franchises Act* (British Columbia), s. 3(1).

The content of this duty has been the subject of considerable judicial commentary. Justice Strathy of the Ontario Superior Court of Justice, as he then was, in the case of *Fairview Donut Inc. v. TDL Group Corp.*, 2012 ONSC 1252 (Ont. S.C.J.), aff'd, 2012 ONCA 867 (Ont. C.A.), leave to appeal refused, [2013] S.C.C.A. No. 47 (S.C.C.) ("*Fairview Donut*"), summarized the duty as follows:

"The content of the duty of good faith and fair dealing has been expressed to include the following:

- to require the franchisor to exercise its powers under the franchise agreement in good faith and with due regard to the interests of the franchisee: *Shelanu*, at paras. 66 and 69;
- to require the franchisor to observe standards of honesty, fairness and reasonableness and to give consideration to the interests of the franchisees: *Landsbridge* at para. 15; *Shelanu* at paras. 5, 68-71;
- to ensure that the parties do not act in such a way that "eviscerates or defeats the objectives of the agreement that they have entered into": *Transamerica Life Canada Inc. v. ING Canada Inc.* (2003), 68 O.R. (3d) 457 (Ont. C.A.) at para. 53; or "destroy the rights of the franchisees to enjoy the fruits of the contract.": *Landsbridge*, at para. 17;
- to ensure that neither party substantially nullifies the bargained objective or benefit contracted for by the other, or causes significant harm to the other, contrary to the original purpose and expectation of the parties: *Katotikidis v. Mr. Submarine Ltd.*, [2002] O.J. No. 1959 (Ont. S.C.J.) at para. 72; *TDL Group Ltd. v. Zabco Holdings Inc.*, [2008] M.J. No. 316 (Man. Q.B.) at para. 272; and
- where the franchisor is given a discretion under the franchise agreement, the discretion must be exercised "reasonably and with proper motive, and may not do so arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.": *Landsbridge*, at para. 17, citing *Carvel Corp. v. Baker*, 79 F.Supp.2d 53 (U.S. D. Conn. 1997) at para. 69; *CivicLife.com Inc. v. Canada (Attorney General)*, [2006] O.J. No. 2474, 215 O.A.C. 43 (Ont. C.A.), at para. 50; *Shelanu* at para. 96"

The essence of the duty is that it limits the ability of franchisors to act in a self-interested manner, i.e., to prefer their own interests over those of their franchisees. While franchisor's may act in their own best interest, they must always give fair consideration to their franchisee's interests. As stated by the Ontario Court of Appeal in the case of *Shelanu Inc. v. Print Three Franchising Corp.*, 2003 CarswellOnt 2038 (CA) with respect to franchisors' common law duty of good faith (codified in statute as the duty of fair dealing):

"If...A owes a duty of good faith to B, A must give consideration to B's interests as well as to its own interests before exercising its power. Thus, if A owes a duty of good faith to B, so long as A deals honestly and reasonably with B, B's interests are not necessarily paramount: see for example *Freedman v. Mason*, [1958] S.C.R. 483 (S.C.C.)."

As noted in the last bullet of Justice Strathy's summary from *Fairview Donut*, above, the duty of fair dealing applies to exercises of discretion under a contract. Accordingly, to the extent that a franchise agreement is drafted in such a way as to create a right in the franchisor to exercise discretion, that exercise of discretion will always be subject to the duty of fair dealing. As such, the franchisor's actions will always be subject to attack on the basis that the franchisor breached the duty by exercising its discretion unreasonably or otherwise without due regard for the interests of the franchisee.

While exercises of discretion are subject to the duty of fair dealing, courts have established that the duty of fair dealing cannot be used to rewrite the express terms of a contract<sup>6</sup>. A simple example of this principle in action can be seen in the 2013 case of *2130679 Ontario Inc. v. Cora Franchise Group Inc.*, 2013 ONSC 3099 ("Cora"), in which a franchisee claimed that a franchisor had breached its duty of fair dealing by locating another franchise nearby, despite the fact that the franchise agreement expressly granted the franchisor the right to do so. The Court held that the franchisee's fair dealing argument failed in the face of the plain language of the franchise agreement:

20 The Plaintiffs rely on *Katotikidis v. Mr. Submarine Ltd.*, [2002] O.J. No. 1959, 2002 CarswellOnt 1655, 26 B.L.R. (3d) 140 (Ont. S.C.J.) where damages were awarded to a franchisee when the franchisor permitted another franchise to encroach on its territory. There was no specific territorial clause in the franchise agreement. In my view, that case is distinguishable. The defendants in that case admitted to a breach of contract, and the passages relied on by the Plaintiffs were concerned with a discussion of whether punitive damages were appropriate.

21 In my respectful view, the claim for breach of contract cannot succeed. I simply do not see how a reasonable cause of action is disclosed in the face of the clear and unambiguous terms of the disclosure document and the franchise agreement. To imply a term that is at odds with an express term is to stretch the duty of fair dealing well beyond any reasonable boundary. Accordingly, paragraphs 35-36, 70-77, 92, 94, 97 are struck without leave to amend. The words "and breach of contract" are struck from paragraphs 1(k) and 97 without leave to amend. [Emphasis added.]

In light of the above discussion, one of the guiding principles that drafters of franchise agreements must keep in mind is that the franchisor's rights should be set out as expressly as possible, particularly when they favour the interests of the franchisor over the franchisee. Moreover, to the extent possible, such rights should be framed so that they do not require an exercise of discretion by the franchisor.

---

<sup>6</sup> *Fairview Donut*, *supra*, at para. 500; See also *Turner v. UAP Inc.*, 2016 ONSC 696 at para. 63; *Cora*, *supra*, at para. 21; *Pointts Advisory Ltd. v. 754974 Ontario Inc.*, [2006] O.J. No. 3504 (Ont. S.C.J.) at para. 55; and *Spina v. Shoppers Drug Mart Inc.*, 2012 ONSC 5563 at para. 148.

### *The Contra Proferentum Rule*

Closely-related to the duty of good faith and fair dealing is the contra proferentum rule. This doctrine applies generally to contracts of adhesion, including franchise agreements. In essence, the rule states that, in interpreting a contract of adhesion i.e., a contract the terms of which have been imposed by one side on the other without any meaningful opportunity to negotiate changes, a court should construe any contractual ambiguities against the party that proffered the contract. The consequences of this rule for franchisors can be serious, as illustrated by the decision of the Ontario Superior Court of Justice in the case of *1230995 Ontario Inc. v. Badger Daylighting Inc.*, 2010 ONSC 1587. In that case the franchisor granted the franchisee the right to perform work outside its territory in designated “work zones”. It was initially understood that the “work zones” did not form part of the franchisee’s territory. However, upon renewal of the franchise agreement, the new agreement was inadvertently prepared so that it defined the territory as including the “work zones”. When the franchisor granted a franchise to a new franchisee in one of the “work zones”, the franchisee sued for breach of contract. In rejecting the franchisor’s argument that the franchisee’s territory excluded the work zones, the Court, at paragraph 168 of its decision, invoked the *contra proferentum* rule, stating:

“Badger says the inclusion of "Work Zones" in the definition of Territory was a mistake. It wants me to remove that phrase and find that the plaintiff's Territory was the City of Sarnia. I am satisfied that it would not be fair to the plaintiff if I did that and, in any event, the *contra proferentum* rule of interpretation prevents me from doing so.”

Accordingly, in addition to taking the duty of fair dealing into consideration, drafters of franchise agreements must also be careful to use very clear language and not to include any mistakes or ambiguities which could provide an opportunity for a court to apply the *contra proferentum* rule.

### *Developments in Franchise Law*

Finally, in addition to the effect of the above-noted interpretive principles, drafters of franchise agreements must also remain abreast of developments in franchise law, which can have drastic effects on the enforceability of franchise agreements, particularly under provincial franchise legislation. Past developments in case law have had significant impacts on issues such as the language that should be used in franchise agreements with respect to franchisee releases (See, in particular, *1518628 Ontario Inc. v. Tutor Time Learning Centres LLC* 2006 CarswellOnt 4593 (Ont. S.C.J.) and *Landsbridge Auto Corp. v. Midas Canada Inc.*, 2009 CarswellOnt 6283 (Ont. S.C.J.)) and the type of language necessary to ensure that the franchisor has the right to retain supplier rebates and earn income on sales of supplies to franchisees (See *Fairview Donut*, *supra*).

As explained in greater detail below, the recent case of *Raibex Canada Ltd. v ASWR Franchising Corp.*, 2018 ONCA (“Raibex”) has underscored, more than ever, the importance of drafting to accommodate developments in the case law.

### **Drafting for Raibex**

In *Raibex*, the Ontario Court of Appeal overturned a 2016 summary judgment decision (*Raibex Canada Ltd. v. ASWR Franchising Corp.*, 2016 ONSC 5575) which, among other things, held that franchisors could not give compliant disclosure under the *Arthur Wishart Act (Franchise Disclosure), 2000* (the “*Wishart Act*”) before all “material fact” information was known and disclosed to the franchisee. The language of the franchise agreement played a major role in reversing the decision on appeal.

The alleged disclosure deficiencies under the *Wishart Act* arose primarily in connection with the franchisor’s failure to disclose the terms of a head lease. As is often the case in franchise sales, no location for the franchisee’s premises had been identified and no head lease had been signed at the time the parties completed the disclosure process required by the *Wishart Act* entered into the franchise agreement. Accordingly, no information about the location or head lease had been included in the franchise disclosure document.

While neither the *Wishart Act*, nor its regulation, expressly require disclosure of a head lease, it was previously established in the Ontario Court of Appeal’s decision in *6792341 Canada Inc. v. Dollar It Ltd.*, 2009 ONCA 385 (“*Dollar It*”) that the terms of a head lease are material and a “critical component of franchise disclosure”.

The franchisor in *Raibex* argued that it could not be expected to disclose information that it did not know at the time the franchise disclosure document was delivered. However, the motion judge rejected this argument and, following reasoning from the decision of *2337310 Ontario Inc. v. 2264145 Ontario Inc.*, 2014 ONSC 4370, wrote at paragraph 78 of her decision that:

“If it is simply impossible to make proper disclosure because material facts are not yet known, then the franchisor is not yet ready to deliver the statutorily required disclosure document. The franchisor must wait – it does not get excused from its statutory obligations”

Had this aspect of the summary judgment decision been allowed to stand, it would have posed major problems for many franchisors with respect to their leasing practices. If franchisors chose to provide a franchise disclosure document before a site had been found and a head lease negotiated, i.e., before all material facts were known, they would be found to have given deficient “premature” disclosure, potentially exposing franchisors to statutory rescission claims for up to two (2) years pursuant to section 6(2) of the *Arthur Wishart Act (Franchise Disclosure), 2000*.

Fortunately, in addressing this aspect of the summary judgment decision, the Court of Appeal took the language of the franchise agreement into consideration. The Court of Appeal held that the motion judge had erred in her analysis of whether or not a disclosure document had been provided for the purposes of section 6(2) of the *Wishart Act*. On this point, the Court of Appeal stated at para. 52 of its decision:

“...whether a breach of [the disclosure obligations under the *Wishart Act*] is sufficiently serious to engage s. 6(2) should be determined on a case-by-case

basis, with a view to all relevant circumstances bearing on whether the franchisee can make a properly informed decision about whether or not to invest. This inquiry requires, where appropriate, taking into account the terms of the parties' franchise agreement."

The franchise agreement provided that both the franchisee and the franchisor were required to collaborate and exercise reasonable best efforts in selecting a location, which constrained the franchisor's ability to unilaterally impose a head lease without considering the franchisee's legitimate interests. The franchise agreement also contained an "opt out" clause which enabled the franchisee to reject a lease and/or terminate the franchise agreement if it found a proposed location or lease unsuitable. The Court of Appeal found that these features distinguished *Raibex* from *Dollar It*. The Court stated (at para. 54):

"[t]hese safeguards, in my view, provide a complete answer to the complaint that the Franchisor's failure to disclose the head lease justified rescission under s. 6(2). The absence of that information had little impact on the Franchisee's ability to make an informed investment decision..."

In making its ruling, the Court of Appeal provided franchisors with a means of continuing the widespread practice of signing franchise agreements with franchisees before locations and head lease terms are known. So long as the franchise agreement includes robust protections for the franchisee, such as collaborative site selection language and an "opt out" clause, which protect the franchisee from having unfavourable lease terms foisted upon it, the franchisee will be in a position to make a properly informed decision whether to sign a franchise agreement, even without head lease disclosure. However, in the absence of such contractual language, the requirement to disclose a head lease as required by the *Dollar It* decision still stands.

From a contract modernization standpoint, the *Raibex* decision may not require major upgrades to all franchise agreements. Many franchise agreements already contain language to the effect that, if a site for the franchisee's premises is not found, or a lease is not signed within a certain period of time after execution of the franchise agreement, either party may terminate the franchise. However, franchisors looking to rely on the *Raibex* decision will undoubtedly want to (i) confirm that their agreements contain such clauses; and (ii) conform the language of such clauses as closely as possible to the clause(s) in *Raibex*, e.g., expressly including both a mutual termination or "opt out" clause and language binding the franchisor to work cooperatively with the franchisee to find a site and lease.

Moreover, while the *Raibex* decision dealt with a situation where a franchisor entered into a head lease and subleased premises to the franchisee, the principles around lease disclosure established by *Raibex* should be presumed to also apply in cases where franchisors either wholly or partly negotiate leases for their franchisees to sign directly with landlords. In such cases, franchisors will still have significant influence over the terms of a lease and will still have an informational advantage over their franchisees. Accordingly, unless franchisors intend to: (i) negotiate both head leases and other leases in advance and disclose them to franchisees per *Dollar It*, or (ii) be entirely "hands off" with respect to leasing, limiting themselves solely to

approving sites and leases and leaving all negotiation to the franchisee, the franchise agreement should be modernized to include the types of clauses noted in *Raibex*.

Moreover, while the above aspects of the *Raibex* decision are limited to questions of lease disclosure, a larger principle is discernable, namely that, to the extent that the franchise agreement protects the franchisee from the risks associated with undisclosed material facts, the failure to disclose such material facts will not diminish the franchisee's capability to make a properly informed decision (and therefore will not engage the rescission remedy under Section 6(2) of the *Wishart Act*). In the absence of further case law confirming this interpretation, drafters of franchise agreements are advised to exercise considerable caution in relying on a broader *Raibex* principle. However, in certain cases, this principle may offer drafters with a thorough knowledge of franchise law a creative drafting avenue to try and address certain franchise disclosure-related risks.

### **Drafting for Technology**

In light of the discussion above, there is little question that the ongoing development of franchise law periodically creates or heightens legal risks that require updating of the franchise agreement. However, the ever-increasing pace of technological change also poses significant challenges. Ongoing developments in technology affect all aspects of franchising, including the provision of training and operational support, franchisee reporting, franchisor audits and inspections, franchisee equipment and upgrading, franchisee advertising and trade channel conflicts between franchisor and franchisee.

Arguably, the chief challenge for franchise agreement drafters in addressing technology is the speed with which new technologies are both adopted and become obsolete. Moreover, exploiting the advantages offered by new technologies often requires franchisors to move quickly. However, many franchise agreements are signed for terms of ten or more years, often plus renewal terms, which means that opportunities to update franchise agreements to accommodate technology-driven change come up infrequently.

In practice, franchisors are often able to rely on existing system modification clauses to compel certain changes or, if the franchisor's express system modification rights are insufficient, to implement changes on the basis of franchisee consent. However, when the franchisor's embrace of new technologies creates changes to the system that benefit the franchisor more than the franchisee (such as implementing remote or automated training and support programs), or perhaps even benefit the franchisor at the expense of the franchisee (such as the creation of new trade channels that may compete with franchisees' businesses), the franchisor will wish to rely, as much as possible, on express contractual rights. To this end, key provisions of the franchise agreement should be drafted in such a way as to create maximum flexibility for the franchisor. A discussion of approaches to drafting several key franchise agreement provisions in this respect follows.

### *Manual*

Traditionally, the benefit of the franchisor's knowledge and expertise were transmitted to the franchisee primarily through in-person training and the provision of hard copy operations manuals. Hard copy manuals have been on the way out for years now, largely replaced by intranets and other online platforms. As a result, franchisors, especially newer ones, may not have, and may never have had, an operations manual in the traditional sense. This being the case, serious consideration must be given to how the franchisor's standards, guidelines, policies, instructions, etc. will be transmitted to the franchisee in practice and the franchise agreement must be drafted or revised accordingly.

If there will be no formal operations manual, then either the manner in which the "manual" is defined in the franchise agreement must be broadened to include virtually any communications from the franchisor in the nature of standards, guidelines, policies, instructions, etc., or the franchisee's obligation to comply with the franchisor's standards, guidelines, policies, instructions, etc. must be framed more broadly in terms of compliance with a "system", which may or may not be communicated through a manual, intranet or through other means. The precise wording of such clauses will vary from case to case; however, in the interest of accommodating future technologies in this regard, the franchisor should reserve very broad discretion regarding the means of disseminating this information.

If it appears likely that the franchisor will disseminate standards, guidelines, policies, instructions, etc., via ad hoc communications, such as periodic e-mails (as is often the case with early stage franchisors), consideration should be given to what happens to this information after termination or expiration of the franchise agreement. Traditionally, franchise agreements stated that the manual was loaned to the franchisor and that it was required to be returned upon termination or expiration of the agreement. To the extent that the franchisor anticipates delivery of hard copy information to the franchisee, this approach to recovering the information still holds. However, to the extent information may be disseminated through e-mail and similar electronic communications, "return" of this information in the hard copy sense is impossible. If such communications are anticipated, the relevant provisions of the franchise agreement should be revised so that the franchisee is required to delete all such information and the principals of the franchisee are required to personally certify such deletion. Franchisor access to and ability to audit franchisee computer systems (as discussed below) and franchisor control of official e-mail and similar accounts should also assist the franchisor in enforcing these sorts of requirements.

### *Training*

With respect to training, most franchisors will still want to do at least part of their initial training in person. However, increasingly, both initial and follow-up training is being done using technology, either in the form of live remote training or through the use of online courses, software and mobile apps. Since training is one of the key forms of support that franchisors are obliged to provide, the franchisor's right to deliver training remotely or through the use of online training courses, software or mobile apps should be expressly set out in the franchise agreement. Again, the range of

possible formats the franchisor may use should be framed as broadly as possible, to accommodate future developments in technology.

#### *Reports and Inspections*

Franchise agreements currently in use generally seem to contain adequate provisions regarding the franchisee's obligations to purchase and maintain computers, POS systems and similar communications equipment. However, increasing use of this equipment to automate franchisee record keeping and reporting to the franchisor is not always adequately addressed.

While many franchise agreements now expressly require the franchisee to ensure its computer systems are online and connected to or available to be remotely accessed by the franchisor's computer systems at all times, franchise agreement drafters may wish to set out the franchisor's rights more explicitly in some respects. For example, franchisors may wish to reserve the right to require the franchisee to actively transmit certain data on a routine basis rather than simply submitting itself to being remotely accessed, or to specify formatting and other parameters for such reports.

In order to ensure that these connectivity and reporting requirements are readily enforceable, drafters should give consideration to creating express default provisions in the franchise agreement that are triggered, for example, by the failure to transmit reporting data when required by the franchisor, inability of franchisee's computer system to be remotely accessed or by the franchisee maintaining materially inaccurate information on its computer system, such as understatements of gross sales. By including default provisions in its franchise agreement to address such failings, the franchisor can shorten or eliminate cure periods that would otherwise apply to general defaults under the agreement and enable itself to act much more quickly to enforce franchisee electronic reporting requirements. The inclusion of such express default provisions also demonstrates the degree of seriousness with which the franchisor views electronic reporting requirements.

In addition to addressing technology with respect to franchisee reporting, franchisors should also consider adding language to accommodate the use of technology to assist them in their inspection and supervision activities e.g., through remote monitoring of franchisee activities using the franchisee's computer system or possibly even the franchisee's security systems. Such measures are not a substitute for conventional inspection rights, such as rights to conduct site visits and implement mystery shopper programs; however, they lay the groundwork for the franchisor to augment its oversight of franchisees using technology, either immediately or in the future.

#### *Advertising*

Like traditional forms of advertising, advertising using technology should be closely controlled by the franchisor. The franchisee should be restricted from electronically disseminating any unapproved materials or messaging, including on the internet and on social media, and franchisor approval of such materials should be subject to the same sorts of conditions that have been applied to traditional forms of advertising, e.g., advertising must conform to franchisor's brand

standards, must reflect favourably on the franchisor and the system, etc. It is also a good idea to expressly restrict the franchisee from maintaining any internet, social media or other sites or accounts that cannot be accessed and controlled by franchisor.

As is generally understood, franchisors should have a robust social media policy and the franchisee should be contractually required to follow such policy or adopt a social media policy approved by the franchisor. Both the franchise agreement and such policies should address the activities of franchisees and their principals on personal social media accounts, including accounts which are not directly related to the franchised business and that do not use the franchisor's marks or other intellectual property. Needless to say, if there is any ambiguity in the franchise agreement on this point, the franchisor may find itself challenged to put a stop to unacceptable online behavior on the personal accounts of its franchisee's principals, for example.

#### *Other Channels*

As noted above, the advent of technology has made new trade channels available to franchises and other businesses. For product distribution businesses, the advent of the online retailing has allowed those businesses to reach customer bases far beyond the reach of traditional bricks and mortar stores and to do so with a speed and efficiency that was not possible through the use of traditional hard-copy catalogues. However, for franchisors, these opportunities have also created challenges, in the form of increased channel conflicts with franchisees.

Many franchise agreements already in circulation contain language stipulating that the franchisor may compete with the franchisee through "other channels" or "alternate channels" of distribution. Traditionally, in the retail or restaurant sectors, these clauses reserved to the franchisor the right to sell products through other bricks and mortar channels within franchisee's markets, e.g., to allow a pizza franchisor to sell frozen pizzas through supermarkets located within the franchisee's territory, or to carve out certain self-contained sub-markets within the franchisee's market area for development by the franchisor, such as enclosed shopping malls, university and college campuses, hospitals, etc. With the advent of online retailing, it has become necessary for franchisors to also give serious consideration to how any existing or planned online retail channels will interact with their franchise system. Franchisor approaches to this problem range from an absolute reservation of rights in favour of the franchisor to the creation of online retail systems that incorporate and provide some compensation to franchisees. Whatever approach the franchisee takes, its rights in this respect should be clearly addressed in the franchise agreement.

Moreover, until recently, it has been primarily product distribution franchises that have been required to address channel conflicts resulting from the operation of online stores. However, as technology continues to develop, more and more service-based business must also now grapple with this issue as it becomes increasingly feasible to deliver certain types of services, e.g., lessons, training, coaching, counselling and similar services through remote online communications or by granting customers access to software services, mobile apps or similar tools. This trend will presumably continue for the foreseeable future. Accordingly, drafters of franchise agreements for these types of service-based franchisors should ensure that "other

channels” reservations expressly include the right for the franchisor to deliver services inside the franchisee’s market using technology.

### **New Approaches to Exclusivity and Territorial Rights**

As noted above, exploiting the promise of new technologies has significant implications for franchisee territories. Perhaps partly as a result of this, there appears to be a trend away from granting protected territories to franchisees. Where such territories are granted, it is increasingly common to see very exhaustive lists of express reservations of franchisor rights to do business within the franchisee’s territory. In the face of such reservations, the amount of protection conferred by the franchisee’s protected territory often ends up being quite limited. Some of the key points addressed in modern territory clauses and the related drafting considerations are discussed below.

#### *No Territory*

As noted above, it is increasingly common to see franchise agreements in which no protected territory is granted to the franchisee. In these cases, it is important to include language in the franchise agreement expressly stating that there is no territory and that the franchisor is free to locate additional franchises or corporate locations anywhere, without regard to proximity. In the absence of such express language, it will be open to franchisees to argue, per the case of *Katotikidis v. Mr. Submarine Ltd.*, 2002 CarswellOnt 1655 (SCJ), that establishing a competing franchise in close proximity to the existing one breaches an implied term of good faith and fair dealing in the franchise agreement, since, by “cannibalizing” the original franchisee’s market, the franchisor is “substantially nullif[ing] the bargained objective or benefit contracted for by the [franchisee].” This argument may succeed even if the existing franchise has no protected territory. However, as noted in our discussion, above, regarding the case of *1117304 Ontario Inc. v. Cara Operations Ltd.*, 2008 CarswellOnt 6444 (SCJ), where the agreement expressly states that there is no territory and that the franchisor has complete freedom to establish additional franchises or corporate locations anywhere, it will be difficult for a “substantial nullification” type argument to succeed.

#### *Common Reservations from Protected Territory Rights*

##### **Encroachment Rights**

If the franchisor has decided to grant a protected territory in its franchise agreement, the drafter should also include a robust encroachment clause in favour of the franchisor. These clauses grant the franchisor the right, provided certain conditions are met, to grant additional franchises within the franchisee’s protected territory. The purpose of these clauses is to allow the franchisor to respond to population or demographic changes in the composition of the territory that occur during the term of the franchise agreement. Typically, the franchisor’s right to encroach on the territory will be conditioned on the franchisor satisfying itself, based on objective data, that there has been a significant increase in population or other change in the market. There will often also be a right

of first refusal in favour of the existing franchisee to open the proposed new franchise(s), provided the existing franchisee is in good standing under the franchise agreement.

Because the exercise of encroachment rights has the potential to seriously affect the profitability, and possibly even the continued viability, of the existing franchisee's business, the duty of fair dealing looms large when the franchisor acts on its encroachment rights<sup>7</sup>. Accordingly, in order to increase the enforceability of these clauses, the pre-conditions to their use should be clearly and objectively expressed in the franchise agreement. If possible, even the threshold changes in the composition of the territory that trigger the franchisor's encroachment right should be objectively set out. While in many cases, this will not be possible, the franchise agreement drafter should seek to make both the triggers and the mechanics of the encroachment right as express, clear and objective as possible.

#### Other Channels

In addition to a contractual encroachment right, and as discussed in more detail above, the reservation by the franchisor of rights to do business through alternate channels of distribution in the territory is more important than ever in the face of new technologies. Such clauses should continue to include traditional channel reservations appropriate to the type of business in question but should also clearly address the franchisor's rights with respect to any online retail channel it may operate. Failure to address direct selling into franchisee territories by the franchisor in the franchise agreements invites franchisee challenges, as evidenced by the successful certification motion by Sears Hometown Store operators in *1291079 Ontario Ltd. v. Sears Canada Inc.*, 2014 ONSC 5190 (Ont. S.C.J.). In the Sears certification motion, the common issues included questions whether Sears had breached its contractual obligations under its dealer agreements, or its fair dealing obligations, by “[s]elling directly to customers located within the class members' Market Areas...”. As noted above, drafters of franchise agreements for certain types of service businesses should also broadly reserve the right to conduct business within the franchisee's territory using remote communications, software services, mobile apps and similar technologies.

#### Key Accounts

In the case of service businesses, in particular, the franchisor may also wish to reserve the right to directly serve or designate others (including other franchisees) to serve key accounts (sometimes also called national accounts) in the franchisee's territory. The idea behind such clauses is that certain clients (the key accounts) may have a presence in more than one franchisee's territory or may otherwise be too big for one franchisee to service in a satisfactory manner. Accordingly, key account reservation clauses reserve to the franchisor the right to directly manage such client relationships and ensure client satisfaction by dictating by whom the client's needs will be served in each franchise territory. If the franchisor determines that it is in the best

---

<sup>7</sup> See generally, *1117304 Ontario Inc. v. Cara Operations Ltd.*, 2008 CarswellOnt 6444 (SCJ); *362041 B.C. Ltd. v. Domino's Pizza of Canada Ltd.*, 2006 CarswellBC 1221 (SC); *Courtesy Chrysler (1987) Ltd. v. Chrysler Canada Inc.*, 2012 ABQB 658; and *Paul Sadlon Motors Inc. v. General Motors of Canada Ltd.*, 2011 ONSC 2628.

interest of ensuring consistent service and client satisfaction to take the work away from the local franchisee, it may do so, provide the key account clause creates express rights in this regard. Needless to say, given the extent to which such clauses may allow the franchisor to encroach on the franchisee's territorial rights, the franchisor's rights should be spelled out unambiguously and in detail.

### Competing Franchises

Many franchise agreements also now contain express reservations of territorial rights that allow franchisors to establish competing franchise systems under different trademarks. Given the popularity of multi-brand franchising at present, even for some start-up franchisors, it makes sense to include an express reservation of franchisor rights in this regard. While establishing a competing brand may not be a breach of contract or of the duty of fair dealing in every case (See *Shelanu Inc. v. Print Three Franchising Corp.*, 2003 CarswellOnt 2038 (CA) at paras. 102-108), prudent drafting demands that the franchise agreement drafter include express reservations along these lines.

### Mergers and Acquisitions

Finally, much of the current popularity of multi-brand franchising has come from franchise merger and acquisition activity. Given the prospect that a franchisor may in future acquire competing franchise systems or itself be acquired by another multi-brand franchisor, care should be taken to ensure that any inter-brand competition that may result from such combinations does not run afoul of the franchise agreement or the franchisor's duty of fair dealing. In the absence of a clear reservation of rights, the outcome such cases may be unpredictable. In the case of *Flair Franchise Systems (1996) Ltd. v. Millebrook Investments Ltd.*, 1996 CarswellBC 2223 (SC), for example, the British Columbia Supreme Court held that the franchisor had breached a non-competition covenant in favour of the franchisee (in effect, the territorial exclusivity clause), because, contrary to the covenant, a group of franchisor companies, with which the franchisor had merged, was operating a competing franchise under another brand within the franchisee's territory. However, in the case of *Simpson v. First Choice Haircutters Ltd.*, 2003 CarswellOnt SSSS (SCJ), aff'd 2004 CarswellOnt 1360 (CA), the Ontario Superior Court of Justice decided, based on considerations of "business efficacy" to interpret the franchisee's franchise agreement in such a way that as to allow post-merger competition by a franchise from a sister brand inside the franchisor's territory. In light of such inconsistent jurisprudence, drafters of franchise agreement should ensure robust express reservations of rights in this regard.

### **Supplies and Authorized Supplier Provisions**

As indicated above, territory rights and reservations from those rights by franchisors address potentially very contentious issues in franchising. Equally contentious is the issue of franchisor and franchisee rights regarding the franchisor's supply chain. Supply chain rights have traditionally been very restrictive from the franchisee's perspective. Most franchise agreements include "authorized supplies" and "authorized supplier" specific provisions that regulate or outright prohibit franchisees from sourcing suppliers or contracting with suppliers of goods and services

other than those pre-approved by the franchisor (and in certain cases, unless purchased or leased directly from the franchisor or one of its affiliates). The rationale being that franchisors use these provisions as a tool to create and maintain uniformity across their franchise system and to derive benefit from achieving economies of scale (which may or may not be passed on to franchisees). Traditionally, these provisions were so broad and onerous that they would extend to every purchase or lease of goods and services made by the franchisee in operating the franchised business. While authorized supplier provisions undoubtedly have benefits, in current thinking and risk management perspectives, a strict approach can be problematic for a number of reasons. Firstly, it may result in increased (unintentional) risk and liability being taken on by the franchisor, for example, where the franchisor supplies goods and services directly to its franchisees. Moreover, it can lead to inefficiencies in a franchise system's supply chain management, create more work for the franchisor's infrastructure, both of which in turn can impede growth (or at least the speed of growth). Finally, it can impact the perceived value and saleability of the franchise system to a prospective purchaser (should this be an exit option). As franchise systems and franchisees become more experienced and sophisticated, the modern approach to authorized supplies and authorized suppliers should be upgraded to reflect that growth and franchisors should consider granting franchisees greater autonomy in supplier decisions. Three ways franchisors can consider taking a different approach include the following.

*Limit Authorized Supplies to “Core” Suppliers*

Modern franchisors should consider limiting the application of authorized supplies and authorized supplier provisions to the core franchised business elements. Many authorized supplies and authorized supplier provisions apply to everything from equipment to professional services and, in other words, capture both supplies integral to core franchised business activities and non-core supplies. The trends in franchising are moving toward allowing franchisees to source their own non-core supplies. The benefits experienced are at least three fold: (i) the franchisor is no longer required to apply its infrastructure to source and manage those particular supply arrangements, (ii) it can serve to reduce the potential liability, or at least reduce the management of complaints with respect to non-core supplies (e.g., this can be particularly beneficial where the franchisor may, for example, be addressing issues with respect to office equipment for which it has mandated certain suppliers), and (iii) franchisees may have the resources to identify suppliers that supply goods or services of better quality, are more efficient, or less expensive (or all of the above) to the benefit of the entire franchise system.

Franchisees are becoming increasingly sophisticated. An increasing proportion of franchisees are multi-unit or multi-brand owners. Franchisees frequently have more experience than franchisors in their local markets (be it for an international jurisdiction, another province, or even a territory nearby). As such, these franchisees are in a better position than franchisors to find preferred and competitive local suppliers. Allowing these franchisees to seek out their own non-core suppliers leverages their experience while still allowing franchisors to maintain uniformity in the core business of the franchise system. Clearly, mechanisms to ensure that franchisors are informed about the suppliers is important to maintain supervision and to assess whether the particular supplier can benefit the entire franchise system.

### *Allow Franchisees to Add Authorized Suppliers*

Alternatively, franchisors should consider including processes through which franchisees can research and recommend new suppliers for approval within the franchise system. Traditionally, some franchise systems (and franchise agreements) included this kind of approach at a general level (i.e., franchisee could suggest their own suppliers for approval). However, engaging franchisees to take on more responsibility to benefit not only their own franchised business, but potentially other franchisees as well (i.e., a form of incentivising the betterment of the franchise system as a whole) takes the concept to another level. Adding this kind of controlled flexibility allows franchisors to take advantage of an increasingly knowledgeable base of franchisees while maintaining uniformity across the franchise system.

Carefully considering how to modernize and customize these provisions becomes especially relevant when a franchise system extends across large geographic regions. The more localities in which a franchise system operates, the greater the potential for local supply chain inefficiencies to exist, and thereby, adopting this kind of approach and mechanism can not only counteract those inefficiencies, but facilitate more rapid growth.

The concept of local sourcing is not new to franchising. It often arises in the international franchising context. Particularly the case with restaurant franchise systems that routinely increase efficiencies by sourcing certain goods from local suppliers.

### *Prepare for Future Innovations*

In addition to considering current trends, franchisors should look to the future of supply chain management when drafting franchise agreements. Franchisors should be prepared to re-evaluate franchise agreements in the face of legal challenges posed by technological innovation to supply contracts. One of the most significant innovations on the horizon is the use of blockchain technology to create what are known as “smart contracts.”

In simple terms, blockchain is a method of recording data in an open, secure database across a system of individuals. Smart contracts are computerized, self-executing contracts programmed into these databases. When certain conditions are fulfilled, smart contracts execute automatically. The benefit of smart contracts is the elimination of transaction settlement costs. In a franchise system, this can lead to significant gains in efficiency. While this may sound like science fiction, large corporations like Samsung and Walmart have already begun to consider using blockchain technology in their global supply chain arrangements.

Though blockchain is exciting from an efficiency perspective, it raises a number of legal questions. For example, it is unclear how open databases will be treated under existing privacy legislation. It is equally unclear how smart contracts can be enforced using contract law principles. While its use has not yet become widespread, franchisors should consider how blockchain may affect their franchise systems going forward, and how the provisions of the franchise agreement should be modified to cater for that technology when it does arrive in some shape or form.

## **System Changes and Modifications**

In addition to accommodating specific sorts of potential system modifications like blockchain, franchisors should also ensure that their franchise agreement includes robust generalized system modification language. Existing system modification provisions are usually fairly general in nature, changes are introduced through the operating manual and franchisees are required to implement those changes pursuant to the terms of the franchise agreement, which provide that franchisees must comply with the operating manual as updated from time to time. However, as the pace of technological and business innovation has quickened, a franchisor's ability to implement changes efficiently and effectively has become more important and certain changes to system modification provisions can facilitate this faster rate of change.

### *Draft for Maximum Flexibility*

It goes without saying that franchisors should draft system change and modification provisions that provide them with maximum flexibility. Case law suggests that including broad contractual language in franchise agreements will go some way to providing some protection from legal challenge when it comes to changes made by franchisors.<sup>8</sup> However, given that the changes being made today are more significant (and different in nature, e.g., technology based) than previously, franchisors should cast their mind to types of changes, and the "categories" of change, that they can foresee. Particularly where the franchise system is a start-up, consider how competitors and franchise systems in analogous areas of business operate, and how those systems and their infrastructure may apply to the franchise system at hand. The franchise agreement should contemplate those specific kinds and categories of changes to assist franchisors, particularly as they grow in size, develop in sophistication and experience, and expand geographically. One poignant example being the recent trend of outsourced delivery for quick service restaurants, and how this may apply to other goods and services in the future.

Caution not to be seen to be "covering the field" with specific examples or enumerated lists of potential changes is also a challenge in undertaking this exercise. Nonetheless, more detailed treatment of the kinds of changes that are likely going to be necessary for the specific franchise system, generally likely to be required at some point for any growing system, and that in each case will permit the franchise system to remain relevant, should form part of the provisions and mechanics dealing with changes to the franchise system.

Additional challenges arise with changes that are not likely to be protected by such drafting, those characterized as "material changes." More particularly, material changes that would reasonably affect a franchisee's decision to purchase the franchise. To the extent franchisors can foresee the implementation of material changes, they should retain express rights to implement those specific changes in their franchise agreements.<sup>9</sup> In addition, franchisors may wish to consider including separate mechanisms that demonstrate procedural fairness and consultation with franchisees (specifically with respect to material and extraordinary changes) as an additional means of

---

<sup>8</sup> See *Bores v Domino's Pizza LLC*, 489 F. Supp. 2d 940, 946 (D. Minn. 2007).

<sup>9</sup> See *Bird Hotel Corp. v Super 8 Motels Inc.*, 246 FRD 603 (D. S.D. 2007).

facilitating effective system change. Having such provisions is one strategy franchisors can use to ensure that franchisees buy in to changes and their franchise system remains agile.

#### *Minimize Resistance to Change*

As noted above, modern franchisors should consider using strategies to encourage franchisee support for proposed changes. These strategies may (or may not) be reflected in the franchise agreement, but implementation strategies that encourage franchisee support will promote the efficient adoption of innovations.

Franchisees resist change for a variety of reasons. Some franchisees fear that franchisors will use them as test subjects. To alleviate this fear, franchisors can consider including language in their franchise agreements requiring that system changes be imposed uniformly in relevant geographic areas. Alternatively, franchisors can first test changes on franchisor-owned locations. Franchisees will likely be less resistant when shown a concrete example of the benefits a franchisors' proposed changes may have. In all circumstances, consultation with franchisee advisory boards prior to implementation can materially increase the cooperation of franchisees.

Franchisors should also consider the cost consequences that franchisees will bear in connection with proposed changes. For certain changes, presenting franchisees with specifications to meet, as opposed to specific goods to acquire, may lessen the burden. This is becoming increasingly true as more franchisor-imposed changes involve computer systems and software. Providing specifications allows franchisees to find cost effective suppliers. Reductions in the cost imposed on franchisees will likely decrease their resistance.

#### *Franchisee Driven Innovation*

Perhaps more critical to the sustained success of a franchise network than the implementation of changes is innovation itself. Modern franchisors should develop processes that encourage franchisee driven innovation while ensuring franchise agreements both protect intellectual property rights and limit franchisor liability.

Franchisee driven innovation is not a new concept in and of itself. Franchisees developed products like the Big Mac and innovations like the drive-thru. Franchise agreements should allow franchisees to present their ideas for changes to the franchise system to franchisors. Additionally, franchise agreements should include provisions that ensure the intellectual property associated with any franchisee developed innovation belongs solely to the franchisor.

A more recent trend is the use of franchisees as data collection hubs. Franchisors are increasingly aggregating customer data recorded by franchisees' to, among other things, improve supply chain management and adjust product offerings.

While customer data aggregation can lead to significant insights into consumer behaviour, it also raises a number of privacy concerns. Canadian privacy legislation generally imposes obligations on organizations that collect, use or disclose personal information in the course of commercial

activities.<sup>10</sup> In the context of a franchise network, this legislation imposes obligations on both franchisees and franchisors to the extent that they engage in the above listed acts.

Franchisors should note that, in general, franchisees may only collect and transfer customer data to the extent that customers provide consent.<sup>11</sup> If franchisees do not receive sufficient consent, transferring data to franchisors is not permissible. Franchisors should further note that, while data storage and analysis may be outsourced to third parties, the franchisor remains responsible for ensuring the security of any data it has transferred to those third parties.<sup>12</sup>

To mitigate these risks, franchisors that aggregate franchisee collected customer data should include provisions in their franchise agreements requiring franchisees to comply with all applicable privacy legislation. Further, franchisors should consider supplementing those provisions with additional requirements in their franchise manual. For example, a franchisor's manual could require franchisees to implement pre-approved privacy policies that practically ensure compliance with privacy legislation. A franchisor's manual may also specify provisions that franchisees are required to insert into any third party data storage or analysis agreements to limit exposure to liability across the network and to the extent that franchisees enter into contracts with customers, prescribed forms of customer agreement or prescribed consent language that must be included in such agreements.

### **Rethinking Common Employer Issues**

While robust system modification clauses can ensure effective ongoing franchisor control of the direction of its franchise system, too much franchisor control in certain areas of its franchisee's operations can be detrimental. This is especially so with respect to the franchisees' employees. In certain circumstances, franchisors who exercise too much control over their franchisee's employees may be found to be "common employers" of those employees. The circumstances under which franchisors may be considered common employers (with their franchisees) has not been fully explored or resolved in Canada. Franchisors that are found to be common employers risk exposure to liability under legislation like the *Labour Relations Act* and *Employment Standards Act*. While this issue has not been the subject of much litigation in Canada, recent American jurisprudence suggests that a franchisor's level of control over franchisee employees will determine whether it is a common employer.<sup>13</sup>

---

<sup>10</sup> *Personal Information Protection and Electronic Documents Act*, SC 2000, c 5, s 4 [PIPEDA]; *Personal Information Protection Act*, SBC 2003, c 63, s 3 [PIPA-BC]; *Personal Information Protection Act*, SA 2003, c P-6.5, s 4 [PIPA-AB]; *Act respecting the protection of personal information in the private sector*, CQLR, c P-39.1, s 3.

<sup>11</sup> PIPEDA supra note 4, s 7; PIPA-BC supra note 4, s 6; PIPA-AB supra note 4, s 7.

<sup>12</sup> Officer of the Privacy Commissioner of Canada "PIPEDA Interpretation Bulletin – Accountability" (April 2012) online: [https://www.priv.gc.ca/en/privacy-topics/privacy-laws-in-canada/the-personal-information-protection-and-electronic-documents-act-pipeda/pipeda-compliance-help/pipeda-interpretation-bulletins/interpretations\\_02\\_acc/](https://www.priv.gc.ca/en/privacy-topics/privacy-laws-in-canada/the-personal-information-protection-and-electronic-documents-act-pipeda/pipeda-compliance-help/pipeda-interpretation-bulletins/interpretations_02_acc/)

<sup>13</sup> See Stephen Hagerdorn, Michael Lotito, John Matter and Adam Wit, "Update on Joint Employer" (Paper delivered at the International Franchising Association Annual Legal Symposium, Washington, DC, 7-9 May 2017).

### *Allocation of Control*

In light of the recent position taken with respect to common employer, franchise agreements should be reviewed and updated to include provisions that:

- explicitly allocate control of franchised business employees to franchisees including with respect to: (i) employment, promotion, demotion, and termination, (ii) classification, compensation, remuneration, payroll and benefits, (iii) employment conditions and policies, and (iv) training and supervision;
- where there are any obligations in the franchise agreement that address selecting and qualifying suitable employees, such provisions are for the best interests of the franchisee and all responsibility for such employees nonetheless remains with the franchisee;
- state that the franchisee takes all reasonable steps to ensure that each of the franchisee's employees do not make any representations or engage in any conduct that could imply or establish a relationship of employment with the franchisor;
- all information, documentation and communication with the franchisee's employees will clearly record that the franchisee is their sole employer;
- the franchisee shall indemnify and hold harmless the franchisor in respect of any claims that the franchisor is the employer of, or otherwise liable for any amounts or benefits owing or potentially owing to, the franchisee's employees; and
- the franchisee shall be solely responsible for complying with all obligations under all applicable laws concerning or regulating the employment relationship between the franchisee and its employees including with respect to taxes (e.g., remitting in a timely manner all applicable taxes owing with respect to employees), employment, labour relations, pensions, workers' compensation, occupational health and safety, and employment insurance.

While provisions in franchise agreements provide a starting point, franchisors should be aware that these provisions will only be effective to the extent that they are consistent with a franchisor's conduct, operations and actions. For example, franchisors should not engage in conduct that suggests they have control over franchised business level employees. Franchisors should be mindful of the risk of fostering direct links to franchise level employees as they increasingly develop and implement software systems that are used directly by such employees.

### *Consider Removing "Anti-Poaching" Clauses*

Modern franchisors should consider removing anti-poaching clauses from their franchise agreements. Traditionally, anti-poaching clauses were included in franchise agreements to prohibit franchisees from soliciting or hiring each other's employees. While these provisions were once commonplace, they have come under increasing scrutiny in recent years.

In the United States, the Department of Justice and Federal Trade Commission characterized anti-poaching clauses as violations of antitrust law in 2016. This announcement led a number of notable franchisors, including McDonald's, Little Caesars and Panera Bread, to remove anti-poaching provisions from their franchise agreements. While there has been little discussion on this issue in Canada, franchisors should be aware that the Competition Bureau could challenge these provisions in the future.

In addition to Competition Bureau scrutiny, it is possible that franchisors that include anti-poaching clauses in their franchise agreements may increase their exposure to potential findings of common employer liability. To some degree, anti-poaching clauses could arguably be construed as direct franchisor involvement in franchisee hiring decisions. While it is doubtful that inclusion of an "anti-poaching" clause in a franchise agreement would, on its own, result in a common employer finding, inclusion of such a clause might contribute to such a finding, in combination with other factors. Franchisors should consider these risks before including anti-poaching clauses in their franchise agreements.

### **Renewal, Transfer and Termination Rights**

While franchisors should avoid exercising control over the hiring and termination of franchisees' employees, the ability to exercise control of the termination, transfer and renewal of its franchisees is critically important. Traditional provisions governing renewal, transfer and termination rights in franchise agreements are still effective, however, franchisors should consider reviewing and bolstering certain provisions that address challenges posed by demographic and technological change. Here are three examples of the sorts of changes that should be made to modernize franchise agreements.

#### *"Designated Successor" Clauses*

As our society ages, more individuals are contemplating succession planning. Franchisees are no different. As more franchisees consider retirement, some franchisors have responded by including "designated successor" clauses in their franchise agreements.

Current transfer clauses often require franchisees to seek franchisor approval of successors at the time when franchisees want to transfer their interest. "Designated successor" clauses increase the efficiency of the succession process by allowing franchisees to seek approval of successors in advance. Franchisors can grant permanent or temporary approval subject to the terms and conditions as they see fit. These provisions can be used to create a more seamless transfer process that benefits both franchisors and franchisees.

#### *Future Advancements and Renewal Clauses*

As technology advances more rapidly, it has become more important to ensure that the same form of franchise agreement governs all franchise arrangements. Traditionally, franchise agreements included the option on the part of franchisors to require the signing of the then current

franchise agreement at the time of renewal, but there was no particular mention of what changes may be necessary.

Because of the rapid pace of technology advancements, it is difficult for franchise agreements to adequately address technological innovations in every context. Consider the disputes that arose between franchisees as online selling gained popularity. Many franchise agreements failed to include provisions governing franchisees' online activity. Though franchise agreements have since evolved to address this, there was a lag period in which the newest form of franchise agreement did not govern all franchisees. During that period, the treatment of online selling across the franchise system was in a state of flux for franchise systems in that situation.

One strategy franchisors can use to ensure coverage of, and uniformity with respect to, technological advancements is to bolster the conditions of renewal clauses in franchise agreements. These provisions should specifically address the requirement that on renewal a new franchise agreement will be entered into between the parties, and that such agreement will take into account the technological advancements that have been (or will be) implemented into the franchise system. By integrating these clauses into franchise agreements, franchisors can minimize uncertainty and disputes due to technological changes across the franchise system.

#### *Customer Data Requirements on Termination*

As alluded to above, many franchisors collect, review and analyze customer data that is initially collected by franchisees. In addition to addressing how this information is treated during the term of the franchise agreement, franchise agreements should also address how this information is treated on termination.

If franchisors collect and use customer data collected by franchisees, they must ensure that their franchise agreements require franchisees to transfer any unremitted customer data to them on termination (and ensure that the franchisee has been required previously to ensure they have the rights to do so). Franchisors should further include provisions that ensure franchisees do not retain any customer data collected post-termination.

#### **Conclusion**

As discussed throughout this paper, franchisors face constant pressure to evolve, whether that pressure comes from technology, changes in social or business practices or changes in the law. To respond effectively to these changes, franchisors and their counsel must remain vigilant with respect to keeping their franchise agreements up-to-date. While no franchise agreement can account for all possible future developments, franchisors who ensure the points discussed in this paper are addressed in their agreements will have taken a major step towards keeping up with the pace of change.