

The general elements in structuring the Franchise Agreement are as follows:

- the granting clause;
- the term;
- rights of renewal;
- initial franchise fee and continuing royalty fees;
- leasing arrangements/leased premises and relocation;
- development/construction/upgrade of the Franchised Business at the premises;
- system modifications;
- Franchisor obligations, including training and continuing assistance;
- Franchisee obligations and standards for operating the Franchised Business;
- advertising and promotion (including fees);
- protection of Trade-marks;
- business records and reporting requirements;
- guarantee and security provisions;
- assignments and transfers;
- default provisions and termination rights;
- restrictive covenants; and
- dispute resolution provisions.

Each of the foregoing is discussed in detail below. Reference is also made to the Glossary of the most commonly used defined terms in a Franchise Agreement.

The Granting Clause

The granting clause is one of the most important provisions in the franchise agreement as it sets out the nature and extent of the rights that Franchisor is granting to Franchisee. Issues that must be considered in drafting, or reviewing, the granting clause consist of the following:

- what rights are being granted i.e. the right to use a Trade-mark and/or trade dress and/or the right to operate a business in accordance with Franchisor's system of operations in conjunction with the Trade-mark/trade dress.
- whether the rights granted are exclusive or non-exclusive. In most cases, Franchisor is granting a combination of exclusive and non-exclusive rights. The Franchisor should consider retaining certain rights notwithstanding that the franchise rights granted may be exclusive within a certain area.
- where Franchisor is granting the right to operate a Franchised Business, the issue of exclusivity is an important consideration. Even if there is an exclusive grant to operate the Franchised Business, the granting clause must address the area over which exclusivity has been granted (i.e. is it limited to certain specified Leased Premises, a defined area or radius around the Leased Premises, or a defined geographical boundary). The Franchisor must also consider whether, and under what circumstances, the grant of exclusivity may be reduced and/or revoked (i.e. does Franchisor want to maintain the right to grant additional licenses after a certain threshold has been reached, which can be defined according to various criteria, such as population density; or does Franchisor wish to have the option to reduce the exclusive area in the event of default by Franchisee).
- notwithstanding the grant of exclusive rights to operate a Franchised Business within a defined Territory, Franchisor must determine whether it wishes to retain the right to offer its products or services through other distribution channels (e.g. Lick's selling frozen hamburgers at the local grocery store, even though the store is within a Franchisee's Territory, or the sale of products over the internet).

In drafting, or reviewing, the granting clause, careful attention must be given to understanding the nature and the extent of the business relationship that Franchisor is prepared to enter into with Franchisee.

The Term

The "Term" is the length of time during which Franchisee has the right to operate the Franchised Business using Franchisor's Trade-marks and the System. There are a number of competing factors involved in determining the Term of a Franchise Agreement:

- what is the minimum period of time required for Franchisee to expect a return on its capital investment and then earn a reasonable profit? The length of time that Franchisee is allowed to operate a Franchised Business can be thought of as akin to an annuity. That is, at the beginning of the contract Franchisee has made a capital investment (franchise fee, construction costs, furniture, fixtures, equipment, etc.) in exchange for the right to generate revenues (and hopefully profits) for a certain period of time. The longer the period that Franchisee has to operate the Franchised Business, the more time Franchisee

has to recoup its initial investment and thereafter build equity and, therefore, the more the Franchised Business is worth to Franchisee.

- conversely, once the Term has expired, Franchisor is able to obtain an additional fee from Franchisee for the right to continue to operate the Franchised Business. Most Franchise Agreements are structured so that a Franchisee may renew for an additional term(s) provided that certain conditions are met, including payment of a renewal fee.
- in the event that Franchisee operates the Franchised Business from Leased Premises, the Term must be limited by Franchisee's ability to remain in the Leased Premises, or find other premises mutually satisfactory to Franchisor and Franchisee.

Rights of Renewal

As discussed above, most Franchise Agreements are structured so that a Franchisee is allowed to renew for additional term(s) so long as certain conditions are met. Providing a Franchisee with the right to continue to operate the Franchised Business beyond the original Term is generally beneficial for both Franchisor and Franchisee. From Franchisor's perspective, having a trained person with whom Franchisor is already familiar continuing to operate the Franchised Business makes it easier to administer the system. From Franchisee's perspective, he or she is able to magnify their existing investment and generate additional revenue without being required to invest at the same level as their original capital investment.

It is important that the Franchise Agreement explicitly state firstly whether a Franchisee has the right to renew and if so, how many renewal terms, and then secondly the terms and conditions under which Franchisee can exercise the right to renew. These conditions typically include the following:

- Continuous substantial compliance by Franchisee with the terms and conditions of the Franchise Agreement, including Franchisor's operating standards;
- Timely payment of all sums owing to Franchisor;
- Continuing rights to occupy the Leased Premises (whether by direct ownership or continuation of the lease or sub-lease);
- Absence of litigation and insolvency or bankruptcy proceedings;
- Payment of a renewal fee. The amount of the renewal fee is a business issue to be established by Franchisor and generally ranges from a percentage of the original franchise fee to the then current initial franchise fee that Franchisor is charging to its new Franchisees. Consideration should be given as to whether it is appropriate for Franchisor to charge Franchisee the then current initial franchise fee since Franchisor will not incur the same costs as it would for a new Franchisee (i.e. finding a location, designing the location, training, printing of new manuals, assistance with opening etc.). Alternatively, the renewal fee may simply be a reimbursement of Franchisor's legal and administrative costs and expenses incurred in connection with the renewal;

- The requirement to provide advance notice of Franchisee's intention to renew;
- Depending on the amount of the renewal franchise fee, in certain cases Franchisor may require the payment by Franchisee of a deposit upon providing notice of his/her intention to renew;
- The requirement to effect reasonable capital expenditures to renovate/modernize the Leased Premises to meet Franchisor's then current image and design;
- The requirement to complete a training or retraining program;
- The execution Franchisor's then current form of Franchise Agreement which may contain, among other things different royalty rates and advertising contributions;
- The execution of a release by Franchisee in favour of Franchisor. Consideration should be given as to whether it is appropriate for Franchisor to insist on the execution of a release as a condition to renewal in circumstances in which the parties may have material differences or are presently in litigation. The duty of fair dealing contained in Section 3 of the Act may require Franchisor to effect the renewal notwithstanding that no release will be provided (although we are not aware of any case law which has addressed this issue).

Franchisors sometimes also choose to avoid granting Franchisee a renewal right, preferring instead to allow them to request a renewal and using some or all of the conditions set forth above as criteria that Franchisor will use to determine whether to consent to such request. The exercise by Franchisor of its discretion in evaluating the foregoing criteria (whether pursuant to a right to renew or a renewal request) imposes on Franchisor a duty of "fair dealing". Reference is made to the heading "WHAT IS THE DUTY OF FAIR DEALING?".

Initial Franchise Fee and Continuing Royalty Fees

The payment of monies by the Franchise represents the most important element of the consideration received by Franchisor for the rights granted to Franchisee. Most franchise agreements provide that the franchise fee has been fully earned and is non-refundable upon payment (generally concurrently with execution of the franchise agreement).

A problem arises if the Franchise Agreement is terminated prior to commencement of operation of the Franchised Business (for example, upon failure of Franchisee to satisfactorily complete training or if satisfactory premises are not found within a certain specified period). Notwithstanding that the Franchise Agreement states that the franchise fee has been fully earned, the duty of fair dealing contained in Section 3 of the Act may require Franchisor to return a portion of the franchise fee.

Although the Courts will likely not interfere with the contractual terms and conditions agreed upon by the parties pursuant to the Franchise Agreement and substitute their own judgment under the auspices of "fair dealing", to address this potential problem, the Franchise Agreement

should clearly spell out that the franchise fee is allocated amongst the various services that Franchisor provides to Franchisee (i.e. a certain percentage for the provision of plans and/or design of the Leased Premises; a certain percentage for initial training, etc, all of which are fully earned on the commencement of each item). If Franchisee terminates the Franchise Agreement subsequent to the commencement of the specific item, Franchisor can retain that portion of the franchise fee that has been allocated to that item since the parties have agreed in advance as to its cost.

Franchisee will pay to Franchisor continuing royalty for the ongoing rights granted to Franchisee to use Franchisor's System and Trade-marks. In respect of these fees, the Franchise Agreement should clearly state:

- that Franchisee is obligated to pay continuing royalty fees to Franchisor;
- on what basis the continuing royalty fees are calculated (i.e. a flat monthly fee or on a percentage basis);
- when the continuing royalty fees are due, the method of payment and interest payable on late remittances.

Any taxes exigible on the initial franchise fee and the continuing royalty fees are also usually stated to be to the account of Franchisee.

Leasing Arrangements/Leased Premises and Relocation

Clauses in the Franchise Agreement dealing with leasing arrangements need to address the following issues:

- if the Leased Premises are already known, the parties should identify them in a schedule to the Franchise Agreement;
- if the Leased Premises have not yet been identified, the Franchise Agreement typically provides that Franchisor is required to consent to the location of the Franchised Business at the time Franchisee enters into the Lease; and
- whether Franchisee is allowed to use the Leased Premises for the operation of any other business.

In many circumstances Franchisor is required to, or wishes, to enter into a direct contractual relationship with the landlord for the lease of the Leased Premises in order to retain control over the Leased Premises and to obtain the benefit of landlord-type remedies in the event of default by Franchisee. If Franchisor is entering into a direct relationship with the landlord, then the Franchise Agreement must also impose an obligation on Franchisee to execute Franchisor's form of sublease agreement in conjunction with the execution of the Franchise Agreement. In addition, Franchisor's should attempt to obtain in its head lease the right of Franchisor to sublet the premises to a bona fide Franchisee without the landlord's consent. If landlord's consent is required, the terms and conditions of the consent should be clearly defined. Care must also be

taken to delete any provision which allows the landlord to terminate the lease if the tenant (Franchisor) wishes to proceed with an assignment of the lease to a Franchisee.

If, instead, Franchisor requires that Franchisee enter into the lease directly with the landlord, then Franchisor will typically insist upon the inclusion in the lease of an option, in favour of Franchisor, to an assignment of the Lease in certain circumstances, generally upon default by Franchisee under the Franchise Agreement or the Lease. To ensure that the lease option agreement is enforceable, the landlord should be a party to this agreement.

A relocation clause allows a Franchisee to change the location from which Franchisee operates the Franchised Business, and is generally used in two circumstances:

- if Franchisee is required to vacate the Leased Premises prior to the end of the Term. In this circumstance, Franchisor may allow Franchisee to continue the operation of the Franchised Business in new premises (usually with Franchisor's approval of the new premises); and/or
- if the initial location becomes unsuitable (i.e. Franchisee "outgrows" the initial location, the surrounding area becomes less desirable), Franchisee may wish to relocate to new premises in order to continue to expand and service the Franchised Business or ensure the continued viability of the Franchised Business; again, with the prior approval of Franchisor.

Development/Construction/Upgrade of the Franchised Business at the Leased Premises

Franchise Agreements typically address the following issues in connection with the construction or development of the Leased Premises:

- whether Franchisor or Franchisee will prepare the plans for the Leased Premises; and
- whether Franchisor or Franchisee will be responsible for the construction and development of Leased Premises.

Usually Franchisor is in a better position to:

- prepare the plans, since it has greater experience in adapting different premises for the operation of the Franchised Business (thereby achieving consistency in look and feel across the System); and
- construct and develop the Leased Premises, since its contractors may have greater experience and Franchisor may be able to take advantage of economies of scale.

If Franchisor is to construct and develop the Leased Premises, then the Franchise Agreement should address whether:

- Franchisee retains Franchisor to construct and develop the Leased Premises to permit its use on a "turn-key" basis;

- who is to bear the sole cost for such construction and development, including extras and cost overruns;
- if Franchisee is to pay for the construction and development, that it be required to provide evidence that it has sufficient capital to finance the construction and development, either from third party lenders or from Franchisee's own resources;
- Franchisor has the discretion to arrange services and materials for the construction and development of the Leased Premises on terms and conditions that Franchisor deems to be reasonable;
- Franchisor may use contractors who are not "at arm's length" with it (as long as the fees charged do not exceed fees generally payable to contractors for comparable work);
- Franchisor is to provide Franchisee with an estimate of the cost of the construction and development (which, typically, is expressed not to be a guarantee of the total cost);
- if the cost is to be paid by Franchisee, the timing of such payments i.e. is Franchisee required to pay a deposit prior to the commencement of the construction and development and additional funds as the development progresses or as a lump sum prior to opening; and
- Franchisor provides any, or disclaims all, warranties beyond the warranties that Franchisor will assign to Franchisee

If Franchisee is to prepare the plans for, construct and develop, the Leased Premises, the Franchise Agreement should state that Franchisor has the right to approve the plans prior to the commencement of the construction and development, and that:

- Franchisee provides evidence that it has sufficient capital to finance the construction and development, either from third party lenders or from Franchisee's own resources;
- Franchisee is obligated to retain the necessary professionals, approved by Franchisor, to effect the construction and development;
- Franchisee obtains all permits and licenses required;
- the construction and development, and the furniture, fixtures and equipment installed at the Leased Premises, comply with Franchisor's plans and specifications; and
- Franchisee completes the construction and development and be open for business within a certain period of time following execution of the Franchise Agreement.

System Modifications

In order to ensure that Franchisor can maintain consistency of the System and adapt to changing market conditions, the Franchise Agreement must impose on Franchisee the obligation to adopt new products, services, Trade-marks etc. at Franchisee's own cost and expense, as these are developed by Franchisor and implemented as part of the System. This would include, for instance, Franchisor's right to update the System's primary mark(s), or even to rebrand the system under a different primary mark, in order to revitalize the System as its brand matures or (in a worst case) deteriorates.

Franchisor Obligations, including Training and Continuing Assistance

Most franchise agreements provide for the training of Franchisee and its key employees both, at or before, the opening of the Franchised Business and on an ongoing basis either as refresher courses or upon the introduction of new projects or services to the System. Franchisors also typically offer advice and assistance to Franchisee on an "as needed" basis throughout the term of the Franchise Agreement.

With respect to initial training, the Franchise Agreement should detail:

- how much and what type of training Franchisee is to receive in connection with the operation of the Franchised Business;
- the number of people who are required/eligible to receive initial training;
- where the training is to take place;
- at whose cost (i.e. cost of instruction and materials versus travel and living expenses). Typically, Franchisee is responsible for his/her own living expenses, and will not be paid, during the training period;
- particulars of the training program (i.e. use of computer system, hiring and training of employees, purchasing, formulation of marketing strategies and programs, etc.); and
- that Franchisee shall hire and be responsible for training its own employees.

As noted, the Franchise Agreement should contain provisions allowing Franchisor to require Franchisee to attend and successfully complete additional or supplementary training programs or other refresher courses. In addition to requiring such courses as a result of new products and/or services becoming part of the System, Franchisors also typically reserve the right to require such training in the event of poor performance by Franchisee. Clauses dealing with additional training should address most of the same issues detailed under initial training, except that Franchisor often requires Franchisee to pay for the additional training itself.

Finally, most Franchise Agreements include provisions allowing Franchisee to request additional or supplementary training from Franchisor, typically, at Franchisee's own expense.

Franchisee Obligations and Standards for Operating the Franchised Business

In addition to Franchisee's payment obligations, the sections in the Franchise Agreement regarding Franchisee's ongoing obligations with respect to the operation of the Franchised Business are extremely important. These ongoing obligations serve as a standard against which Franchisee's conduct will be measured in determining whether Franchisee is operating the Franchised Business consistent with Franchisor's system of operations. They are also the means by which Franchisor is able to ensure consistency of quality and a uniform look and feel throughout the system. Other than for non-payment of amounts owing to Franchisor, failure of Franchisee to comply with his/her continuing obligations with respect to the operation of the Franchised Business (i.e. failure to follow recipes, appearance of the premises, poor service, poor quality of product, etc.) is the most important basis for terminating the Franchise Agreement.

The following requirements should be addressed:

- that a specific individual devote his/her full time and attention to the Franchised Business;
- that Franchisee be required to comply with all mandatory specifications, standards and operating procedures prescribed by Franchisor from time to time, whether in the Manual or otherwise communicated to Franchisee;
- that Franchisee secure and maintain all licenses and permits required to operate the Franchised Business and that it operate the Franchised Business in compliance with all applicable laws, regulations, etc.;
- that Franchisee provide prompt, courteous and efficient service;
- that Franchisee maintain adequate and properly trained staff;
- that Franchisee obtain and maintain an adequate supply of marketing and promotional materials;
- that Franchisee participate in Franchisor's advertising programs;
- that Franchisee participate in Franchisor's training programs;
- that Franchisee maintain sufficient working capital to operate the Franchised Business;
- that Franchisee install and maintain any required point-of-sale system or other connectivity to Franchisor;
- that Franchisee purchase only from approved suppliers and maintain adequate supplies of inventory;
- the treatment of discounts and rebates;

- that Franchisee allows Franchisor to enter and inspect the Leased Premises for the purpose of ensuring that Franchisee is operating the Franchised Business in accordance with the System;
- that Franchisee maintain the physical condition of the Leased Premises and the furniture, fixtures and equipment used in the operation of the Franchised Business;
- that Franchisee be required to maintain certain types and minimum amounts of insurance;
- that Franchisee obtain and maintain certain credit arrangements;
- the prompt payment by Franchisee to the suppliers and other creditors of the Franchised Business; and
- that Franchisee may not subcontract its obligations to operate the Franchised Business.

Advertising and Promotion (including fees)

One of the benefits of a franchise system is the ability of Franchisor to achieve economies of scale and purchasing power in the development and implementation of marketing and promotional campaigns. Relatively small and regular contributions by Franchisees towards an overall marketing and promotional effort can create a presence in the market beyond what an individual Franchisee could achieve with the same expenditure of funds.

Sections dealing with advertising and promotion in Franchise Agreements generally should address the following issues:

- the obligation of Franchisee to contribute to Franchisor's national and/or regional advertising fund. These clauses should include:
 - that Franchisee is obligated to pay an advertising contribution to Franchisor;
 - the basis on which the advertising contribution is calculated (i.e. a flat monthly fee or on a percentage of Gross Sales basis);
 - when the advertising contribution is due (normally payment is required at the same time as the payment of the continuing royalty fees); and
- an acknowledgement that Franchisor's advertising programs are to benefit the System as a whole and not a particular Franchisee and that Franchisee has no entitlement to the expenditure of any particular portion of the fund in the local area in which the Franchised Business is located;
- the obligation of Franchisee to expend certain additional monies, either on a flat fee basis or a percentage of Gross Sales basis, in order to promote the Franchised Business within its own local marketing area;

- the obligation to co-operate with other Franchisees within a certain geographic location or market area for joint advertising campaigns, if required by Franchisor;
- an acknowledgment that:
 - Franchisor has the right to delegate its marketing and promotion responsibilities;
 - the designees may not be “at arm’s length” with Franchisor;
 - the amount of the fees payable to designees who are not “at arms length” with Franchisor is in Franchisor’s discretion, provided that such fees are competitive with fees generally charged in the marketplace for goods/services of comparable quality; and
 - Franchisor shall be entitled to charge an administrative fee for administering the advertising fund.

The sections should also detail how Franchisor will use the advertising contributions, that Franchisor has discretion as to whether to expend the funds, and the type of media and the selection of content. Further, Franchisor should make it clear that Franchisor is under no obligation to ensure benefits directly or proportionate to the receipt of advertising contributions from Franchisee;

Protection of Trade-marks

At the heart of any Franchise Agreement lies the grant to Franchisee of a non-exclusive non-transferable license to use Franchisor’s Trade-marks at the Leased Premises or in the Territory during the Term, for the sole purpose of operating the Franchised Business. In addition to this limited license, a well-drafted Franchise Agreement will also contain a detailed array of obligations and restrictions on Franchisee to protect those Trade-marks from misuse and infringement. These provisions typically include requirements that:

- the use of the Trade-marks does not confer on Franchisee any ownership rights;
- all goodwill associated with the Trade-marks vests with Franchisor;
- Franchisee must display a notice indicating that Franchisee is a Franchisee of Franchisor and a licensee of the Trade-marks;
- the parties must co-operate in the event of an action for infringement by a third party;
- Franchisee must conform exactly to Franchisor’s instructions when reproducing the Trade-marks; and
- Franchisee may not use or register the Trade-marks in its own name or in the name of any other person.

Business Records and Reporting Requirements

The obligation to maintain business records and to report details of the operations of the Franchised Business is obviously critical, especially where Franchisee is paying continuing royalty fees and advertising contributions as a percentage of Gross Sales. However, the purpose of this obligation is greater than merely to ensure that Franchisee is submitting the proper amounts: it is a central part of Franchisor's ongoing effort to supervise the operations of each Franchisee and thereby to maintain consistency across its System.

Franchise Agreements must address a number of issues relating to business records and reporting requirements, including the obligation to:

- Maintain proper records. Most of the information that a Franchisee is required to record and maintain is the same as any business would use (i.e. invoices, payroll records, sales tax records etc.), while other types of information may be specific to the nature of the franchise system. The Franchise Agreement should set a minimum time period for the retention of records (typically with a view to applicable statutes of limitation and reassessment periods of relevant taxation authorities).
- Use an approved bookkeeping or accounting system. Again, in many instances Franchisor will only require Franchisee to purchase an off-the-shelf accounting system. In other circumstances, Franchisor will have developed or modified an accounting software system which Franchisee will be required to use.
- Provide certain reports and financial information to Franchisor. This obligation is not just limited to providing reports of Gross Sales, but includes quarterly and yearly financial statements, and with different levels of comfort (i.e. internally prepared or externally prepared). If externally prepared, whether the standard of review of the statements is 'notice to reader', 'review engagement' or 'audited'.
- Allow Franchisor to inspect Franchisee's records during normal business hours. Periodic inspections are a good way for Franchisor to see first-hand whether Franchisee is complying with its record-keeping (and other) obligations. Some Franchisees have developed unique skills on manipulating cash registers etc. which allows them to underreport Gross Sales. The obligation to maintain and report records is an important tool in ascertaining whether Franchisee is complying with the obligation to report all Gross Sales;
- Allow Franchisor to inquire into Franchisee's third party relationships (e.g. bankers and suppliers). The purpose of this provision is again to provide Franchisor with further information regarding Franchisee's compliance with the covenants contained in the Franchise Agreement.
- Purchase and/or maintain certain POS and Computer Equipment, which must be compatible with the equipment used by Franchisor. With the continuing march of technology and the use of the internet, Franchisors are becoming more sophisticated in requiring Franchisees to use certain point of sale equipment as well as all of the necessary

supporting hardware and software (e.g. dedicated computers, phone lines, modems, printers and other related accessories) for the purpose of recording, maintaining and reporting to Franchisor. The Franchise Agreement should also provide Franchisor with the right to electronically retrieve data and information from Franchisee's equipment as well as impose on Franchisee the obligation to replace such systems in order to maintain compatibility with Franchisor's systems;

- Maintain the confidentiality of the information provided to Franchisor by Franchisee. Care must be taken to ensure that there is no obligation on the part of Franchisor to review the information provided or to advise Franchisee in respect thereof. The authors query whether this type of exclusionary language would absolve a Franchisor from liability (especially in blatant cases) in view of Franchisor's duty of fair dealing pursuant to Section 3 of the Act.

Guarantee and Security Provisions

The Franchise Agreement should grant Franchisor a security interest in all of Franchisee's assets and undertaking as security for the performance of all of Franchisee's obligations. Franchisee should execute a general security agreement in favour of Franchisor which must be registered in accordance with the provisions of the *Personal Property Security Act (Ontario)* in order to perfect its security interest. Franchisors will generally subordinate this security interest to security interests granted by Franchisee for funds necessary to establish the Franchised Business. In addition, where Franchisee is a corporation or other non-natural person, the individual principals of Franchisee are often required to give Franchisor a personal guarantee of Franchisee's obligations.

Assignments and Transfers

Assignment provisions address the possible assignment of the Franchise Agreement by both Franchisor and Franchisee. The section dealing with the right of Franchisor to assign is typically quite simple: Franchisor has the ability to assign all of its rights and obligations under the Franchise Agreement to a third party; once the third party has agreed to assume the Franchise Agreement (and its inherent rights and responsibilities), Franchisor is released from further obligation.

Assignments by Franchisees are usually much more restrictive, and the relevant provisions are much more detailed. First, a well-drafted Franchise Agreement will typically contemplate all of the circumstances which constitute (or which should be deemed to constitute) an assignment of the Franchise Agreement or the ability to control or direct the actions of Franchisee (i.e. sale of assets, sale of shares, or partnership interest in a Franchisee which is a corporation or partnership, or the issuance of additional shares or partnership interests, the grant of a security interest to a third party lender and the realization against the assets of the Franchised Business by a receiver or trustee).

Secondly, the Franchise Agreement will typically provide that no part of the agreement may be "assigned" (under the broad definition discussed above) without the prior consent of Franchisor. Since the statutory duty of fair dealing under Section 3 of the Act means that Franchisor must act

in good faith and in a commercially reasonable manner in making its decision whether to grant such consent, the Franchise Agreement must clearly state the criteria that Franchisor will use to determine whether or not it will allow any proposed assignment to proceed. Although certain of the criteria are inherently subjective (e.g. Franchisor considering the qualifications, apparent ability and credit-worthiness of the proposed assignee), Franchisor should try, as much as possible, to use objective measures to assess these subjective criteria.

Further, the Franchise Agreement should clearly detail the conditions precedent for the completion of the assignment, including some or all of the following:

- that there be no existing default;
- that all accounts be settled, both with Franchisor and with third parties (e.g. suppliers and taxation authorities);
- that Franchisee deliver a complete release in favour of Franchisor;
- that the proposed transferee demonstrate to Franchisor's satisfaction that it meets Franchisor's standards, including business, ethical, reputational and financial criteria;
- that the shareholders of the proposed assignee execute personal guarantees of the proposed assignee's obligations;
- that the proposed assignee enter into a written agreement agreeing to assume all of Franchisee's obligations. In many instances, Franchise Agreements provide Franchisor with the right to require the assignee to execute its then current franchise agreement which may contain higher royalty rates or greater expenditures for marketing and promotion. If Franchisor requires the assignee to execute a new Franchise Agreement and there is any substantive difference between the new Franchise Agreement and the existing Franchise Agreement (or if Franchisor's involvement in the assignment transaction goes beyond the mere exercise of its right to approve the assignment, coupled with requiring that Franchisee pay a reasonable transfer fee), Franchisor should ensure that it has delivered a Disclosure Document to the assignee in compliance with the provisions of the Act;
- that the assignee and its key employees successfully complete Franchisor's training program;
- that Franchisee pay certain fees (which can be a flat fee or a percentage of the consideration for the assignment); and
- that Franchisee pay all of Franchisor's out-of-pocket costs for administering the transfer.

The assignment conditions may be modified somewhat to permit transfers to family members or upon death or disability.

Many Franchise Agreements also allow Franchisor to acquire the Franchised Business on the same terms and conditions as is contemplated by the assignment, by way of a right of first refusal.

Default Provisions and Termination Rights

Integral to the viability and success of the Franchise System is the ability of Franchisor to terminate a Franchisee if s/he fails to comply with the terms and provisions of the Franchise Agreement. Franchisor should also maintain termination rights prior to the commencement of the Franchised Business (i.e. prior to the signing of the lease for the Leased Premises or as a result of Franchisee's failure to successfully complete Franchisor's training program). However, in most circumstances, the termination of Franchisee will occur as a result of a breach (or a series of breaches) of the Franchise Agreement.

If the Franchise Agreement elsewhere provides Franchisee with the opportunity to seek alternative dispute resolution (i.e. mediation or arbitration), in the event of a dispute between the parties, Franchisor will want to take care to exclude this right in the event that Franchisor wishes to terminate Franchisee (i.e. Franchisee cannot "arbitrate" or "mediate" Franchisor's ability to terminate).

Termination rights typically arise "automatically" in the following circumstances:

- if Franchisee commits an act of bankruptcy, becomes insolvent or a petition is filed and not discharged within a certain time frame;
- if a receiver is appointed over the Franchised Business or distress proceedings are commenced;
- if Franchisee ceases or takes steps to cease the operation of the Franchised Business or surrenders or otherwise loses its right to occupy the Leased Premises; or
- if Franchisor withdraws the right to use the Trade-marks.

The point of ensuring that the Franchise Agreement is "automatically" terminated is so that Franchisor can maintain control over the System and the Trade-marks effective to the date of the defaulting event. Often, however, Franchisor will only subsequently find out that one of the aforementioned events has occurred; this highlights the need for rigorous reporting requirements on Franchisee and vigilant monitoring by Franchisor.

Termination rights can also arise (typically on a stipulated period of notice and, in many cases, with an opportunity to cure) in the following circumstances:

- if Franchisee fails to pay amounts owing to Franchisor or to suppliers of the Franchised Business;
- if Franchisee fails to submit reports, etc.;
- if Franchisee attempts to assign the Franchise Agreement or his or her rights under the Franchise Agreement without compliance with the assignment provisions;
- if someone other than Franchisee or a designated manager manages or controls the Franchised Business;
- if Franchisee fails to maintain insurance or such insurance has been cancelled or is threatened to be cancelled;
- if Franchisee engages in conduct harmful to the Trade-marks or the goodwill of the System;
- if Franchisee is in default of any of the other terms or conditions in the Franchise Agreement or in any other agreement between Franchisee and Franchisor or its affiliates;
- receipt by Franchisee of more than a certain number of default notices; or
- if Franchisee willfully or fraudulently misrepresents any fact, condition or report.

Given the risks involved in properly terminating a Franchise Agreement, the circumstances in which Franchisor is able to exercise its rights of termination should be clearly detailed. As an alternative to termination, the Franchise Agreement should provide Franchisor with the right to appoint a manager to oversee and manage the operations of the Franchised Business.

If Franchisor makes the decision to terminate, the Franchise Agreement should clearly state the rights and responsibilities of each of the parties thereafter. Upon termination Franchisee's responsibilities include the obligation to:

- cease operation of the Franchised Business and all use of the Trade-marks;
- remove from the Leased Premises and otherwise discontinue the use and display of all distinctive equipment, signs, invoices, etc. which display the Trade-marks or are associated with the System;
- return the Manual and other confidential materials to Franchisor;
- notify phone companies of the termination of Franchisee's rights to the phone number and listings of the Leased Premises;

- pay all amounts owing to Franchisor; and
- vacate the Leased Premises if Franchisor has rights to the Leased Premises, whether by way of a lease directly with the landlord or by way of an optional right of assignment of Franchisee's lease.

The Franchise Agreement should articulate the consequences of Franchisee's failure to perform these obligations, including the ability of Franchisor to obtain injunctive relief (critical where Franchisor is continuing to use the Trade-marks) and the ability of Franchisor to take steps to cure a default. The Franchise Agreement may also set out a genuine pre-estimate of the damages that will accrue to Franchisor as a result of such failure.

Additionally, the Franchise Agreement should provide Franchisor with certain rights upon termination, including:

- the right to purchase the assets of the Franchised Business;
- the right to enter the premises;
- the right to operate the Franchised Business and to retain all profit therefrom;
- the right to claim damages; and
- the survival of these rights (as well as Franchisee's obligations detailed above) beyond the termination of the Franchise Agreement.

Restrictive Covenants

Generally, there are three elements to restrictive covenants in Franchise Agreements: one for the treatment of confidential information, another restricting Franchisee from competing during the Term and for a certain period of time subsequent to the Term, and a third restricting Franchisee from interfering with the operation of the Franchised Businesses of other Franchisees.

Part of the value of any System is in the knowledge base that Franchisor has developed for various aspects of the Franchised Business. The disclosure of this knowledge base to parties outside of the System could obviously cause harm to Franchisor and to its other Franchisees. As such, the Franchise Agreement should state that Franchisee:

- acknowledges that all matters relating to the operation of the Franchised Business are confidential and a trade secret of Franchisor;
- agrees to maintain the information as confidential during, and subsequent to, the Term;
- agrees to not use the information in any other business; and
- agrees to not copy or reproduce the information.

Covenants not to compete during the Term and for a certain period of time subsequent to the Term are also critical to the integrity of the System. Well-drafted, reasonable non-competition covenants are enforceable, but Franchisors (like many clients, in other areas) are often tempted to over-reach. Care must be taken to ensure that these clauses limit Franchisee's rights only to the extent necessary to re-establish Franchisor's presence in the market previously occupied by Franchisee. Factors that the courts will take into account in determining the enforceability of a non-competition covenant include the geographical area that the Franchise is restricted from, the duration of the covenant and whether a non-solicitation covenant would suffice in the circumstances.

Franchisee should also be restricted from soliciting employees of other Franchisees or of Franchisor and from diverting any business away from the Franchised Business.

Dispute Resolution

Franchisor may wish to consider providing for mediation and/or arbitration to resolve disputes with a Franchisee. The benefits are well known – they can be cheaper and quicker methods for resolving dispute, and they are confidential. However, if an alternate dispute resolution mechanism is provided for, the Franchise Agreement should expressly exclude matters relating to Franchisor's Trade-marks and to its right to terminate the Franchise Agreement.

