

THE FRANCHISE PLAYER

by R. Lorne Jamieson

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For people with an entrepreneurial bent, or for business people who have some extra cash and wish to expand their business holdings, franchising may appear to be the way to fulfil those ambitions. Beware, there are more failures than successes in the franchising business.

Until recently, purchasing a franchise business in Canada placed the risk squarely on the Franchisee. Only two provinces have legislation which provides some protection to the Franchise purchaser. Those two bastions of free enterprise, Alberta and Ontario, have passed legislation requiring disclosure by the Franchisor to the proposed Franchisee. The groundbreaking legislation in Alberta requires that the Franchisor provide information to its proposed purchaser that includes the complete financial background and current status not only of the Franchisor but also details on the officers and directors of that organization. For those personnel involved in the Franchising company, the information includes corporate experience, bankruptcy proceedings, criminal records or civil actions in which the person may have been involved. Legal actions against the Franchisor must also be disclosed. This information may be a good indicator of how Franchisees have been treated.

The recently amended Franchise Act in Ontario now requires all Franchisors selling *out of that province* to provide this type of information to any proposed Franchisee. As most head offices of Franchisors operate out of Ontario, this provides some protection to the purchasers. It will be interesting to see if Franchisors move their head offices to jurisdictions requiring less strict rules.

Franchise fees can run from a low of \$10,000 to over a million dollars for a household-name, successful franchise. If a person is considering the purchase of a franchise the first place they should go after receiving the preliminary documentation from the Franchisor is to their accountant to have the figures analysed. The *pro forma* financial statements put out by many Franchisors are outlines of the most favourable scenario for the proposed business, although usually expressed as a “typical operation” of an XYZ franchise outlet.

Many franchise agreements extend to more than 50 pages. This agreement is usually heavily weighted in favour of the Franchisor and requires the Franchisee operator to comply with some very strict rules. Many of these rules are justified to protect the Franchisor’s names, trademarks and quality control. When the franchise agreement gives the Franchisor complete control over the sale of the Franchise, however, one has to question why the Franchisee’s sale price has anything to do with the protection of the Franchisor (unless, perhaps, there is a right of first refusal). If a Franchisee has turned the local outlet into a very successful financial operation and can command a premium price because of the effort and management put into the business, why should the Franchisor have the right to say you can’t sell it at market value?

In addition, the Franchisor will usually look for a hefty transfer fee on the sale, which could cause the entire deal to collapse. Unless you are very comfortable with interpreting lengthy and involved contracts, it is a wise move to turn to your lawyer for a review of the contract and to obtain an opinion on the pitfalls within the contract. The possibility of the Franchisee obtaining

any major concessions from the Franchisor on its contract are slim, but at least the Franchisee knows the rules by which it is operating and can make an informed decision.

Paying an accountant and lawyer a few thousand dollars for their time and expertise might be the best franchising investment made by a prospective franchise buyer.

One area where the Franchisee might wring some concessions is on the costs of a turn-key operation. In this arrangement, the Franchisor names the contractors and the suppliers and the total costs that are involved in the installation. If the work can be done with the same specifications at a lower cost locally, it may result in the Franchisor allowing the Franchisee to proceed on that basis. If the Franchisor is not prepared to agree with this arrangement, the proposed Franchisee should investigate whether there is some sweetheart deal between the Franchisor and the contractors/suppliers whom it insists will get the contracts.

Protected trading areas have become a major source of litigation between Franchisors and Franchisees. In the U.S. there have been a number of lawsuits over Franchisors allowing a competing Franchise to open in the immediate area of an already operating business under the same franchise. The Franchisors try to justify this by suggesting that more businesses providing the same service will result in higher traffic for all concerned and increase everyone's business. Not likely!

Another serious problem is the lack of continuing support for the Franchisee from the Franchisor. Having received a major up-front franchisee fee, based on glowing promises that the Franchisor will be on hand to assist in resolving all problems that arise, some Franchisors just fade back into their head offices to be heard from only if the royalty fees are not paid. A prospective franchisee should talk to both successful and disgruntled franchisees to obtain as complete a picture as possible of what they might be getting into if they sign the franchise agreement. Franchising remains very much a business where the "caveat emptor" rule remains king.

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