**ONTARIO BAR ASSOCIATION**

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**Advanced Topics in Franchising**

**THE PURCHASE AND SALE OF FRANCHISES AND FRANCHISE SYSTEMS[[1]](#footnote-2)**

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**I. Introduction**

Canadian franchising is on the rise, spawning an increase in the sale and purchase of franchises and entire franchise systems. Well-known brands such as Dollar Thrifty, Extreme Pita, Tim Hortons, Shoppers Drug Mart, Grounds Guys, Mr. Lube, Molly Maid, Prime Restaurants, New York Fries, St-Hubert, and Landing Group are just some of the franchise systems that have changed hands in Canada over the past few years. There are many factors that make franchises and franchise systems enticing targets for acquisition. Successful franchise systems provide, among other things, predictable long-term revenue streams and established market penetration. Moreover, purchasing a franchise system might also be an effective way for existing brands to expand to a new jurisdiction and/or respond to and overcome competition in the marketplace.

Regardless of the nature of the acquisition, prospective purchasers must conduct targeted due diligence to assess a target and the target’s business, evaluate whether the deal makes sense, and determine the best ways to mitigate the risks associated with the acquisition. While there are general issues that pertain to any acquisition, mergers and acquisitions of franchises and franchise systems involve a number of unique matters that differentiate them from mergers and acquisitions of other businesses. This is in part due to the nature of the assets of the business that is being purchased as well as the unique regulatory environment that governs franchising in certain Canadian provinces.

This paper will provide an overview of the practical considerations relating to mergers and acquisitions of franchises and franchise systems, including hppow to effectively conduct franchise-specific due diligence, considerations that are unique to franchising in terms of structuring the transaction and drafting the purchase agreement, techniques for mitigating risk, and best practices for staging a franchise system for sale.

**II. Franchise Due Diligence**

**(A) Franchise-Specific Due Diligence Overview**

Franchise systems create unique considerations in a due diligence process. Most franchise systems are not predominantly comprised of hard assets, but are rather a collection of intangible assets. The intangible assets—the franchise relationships, intellectual property rights, goodwill, knowhow, and supply chain networks, to name a few—are often worth far more to a prospective purchaser than any of the brick-and-mortar assets. This can sometimes pose significant challenges to any fact-finding due diligence exercise related to the purchase of a franchise system, as discussed in more detail below. Conversely, for purchasers of one (or a few) unit franchise(s), the focus is on the brick-and-mortar assets owned by the selling franchisee and the existing/future relationship with the franchisor.

Due diligence of franchise system acquisitions is also unique because franchising is subject to specific regulation in the five provinces that have enacted franchise-specific legislation.[[4]](#footnote-5) The main features of the legislation are pre-sale disclosure, the duty of good faith and fair dealing, and the right of franchisees to associate. The target’s noncompliance with these statutes can give rise to significant statutory liabilities and have the effect of reducing the value of the target franchise system or even derailing a potential acquisition. However, determining strict compliance with these regulatory requirements can be a time and labour intensive process.[[5]](#footnote-6) In the context of a unit franchise sale, compliance with these statutes will not be overly relevant to the transaction unless the prospective purchaser is purchasing shares in the franchisee entity and wants the benefit of any existing claims against the franchisor.

Franchise-specific due diligence is a necessary subset of the overall due diligence process to ensure that the prospective purchaser is acquiring the business that it has bargained for, that the purchase price reflects the value of the business, and that there will be no post-closing surprises. Franchise-specific due diligence for franchise system acquisitions must examine, among other things, unit level economics, franchisee relationships, legal compliance with franchise-specific legislation, registration and protection of intellectual property rights, and network infrastructure. Robust due diligence can confirm, qualify, or undermine the potential benefits of purchasing the franchise system, and also provide a sense of whether the purchaser will be able to meet its goals as they pertain to successful operation and growth of the system post-closing. If the deal proceeds, franchise-specific due diligence will allow the prospective purchaser to anticipate and mitigate the risks discovered with respect to the system.[[6]](#footnote-7) Franchise-specific due diligence for unit franchise acquisitions will largely focus on evaluating the hard assets and associated liabilities, historical financial statements, overall system health, and the terms and conditions upon which the purchaser will hold a licence with the franchisor (particularly if the terms will differ from those of the existing franchisee).

The extensive information required for proper franchise-specific diligence of franchise system acquisitions means the purchaser must request a broad list of documents. The focus will usually begin on the contents of any required set of disclosure documents and the terms of the franchise agreements (standard forms and/or negotiated variations). However—depending on the scope of the diligence—the request list could also include: supply chain contracts; practices and policies related to the receipt, retention, and/or sharing of rebates; financial statements and information related to the administration of any advertising fund; earnings projections, business plans or worksheets; any policies dealing with a franchisee advisory council or franchisee association; and/or correspondence between franchisors and franchisees on serious issues (such as complaints, defaults, or terminations). The prospective purchaser might also want to examine the franchise application forms and any accompanying documentation. If there are any internal financial reports that the franchisor uses for management purposes, these are a useful means of evaluating the financial health of the system and any geographic or historic trends.

**(B) Scope of Due Diligence**

Conducting thorough due diligence within time and budget constraints is a beast of a problem in the best of times, but it can become hydra-headed when the acquisition target is a mature franchise system with hundreds, or even thousands, of franchisee units. In these cases, it may be practically impossible to conduct adequate due diligence on every relevant document. In those circumstances, the purchaser may need to consider a more balanced and manageable scope of due diligence that still provides a meaningful and valuable outcome. One approach is to limit the scope of the due diligence by segregating the information, agreements, and documents to be reviewed by date (e.g., agreements made and franchise disclosure documents provided over the prior three or four year period), jurisdiction, franchise type, issues of concern, and other relevant categories, followed by a “deep dive” into a selection of individual franchisee files, if warranted.In the context of a unit franchise sale, there is not ordinarily a need to scope the diligence exercise, given the size of the transaction, but rather the purchaser can (and should) thoroughly review all information and documents pertinent to the unit.

The starting point is determining the manner in which the information, agreements, and documents are to be segregated, if there is a coherent way to do so. Some systems are so large that this is more difficult than it seems. For example, franchisees in Canada can often be subdivided into those located in regulated provinces versus those located in unregulated provinces. There may also be a few multi-unit franchisees or master franchisees that are on broadly similar documents. In addition, it is useful to distinguish between template documents and those that have been heavily negotiated. Depending on the target, the prospective purchaser will have to decide whether examining template franchise disclosure documents and franchise agreements is sufficient or if a more exacting review of customized documents and agreements is warranted. Lastly, it may also be necessary to limit initial diligence review to predominantly documents and agreements from recent years, particularly where there have been no material changes within the last few years, or whether all documents ought to be reviewed. Although the longer of the two limitation periods for statutory rescission is two years from the date the franchisee signed the franchise agreement, reviewing disclosure documents and agreements for the prior three or four year (or longer) period is advisable to account for any potential statutory misrepresentation claim or other statutory or common law claim that would be subject to the ordinary provincial statutory limitation periods. Determining the scope of the diligence in this way still provides the purchaser a reasonable opportunity to review and analyze the franchisor’s processes and practices while highlighting any potential concerns in need of further “deep dive” diligence into specific franchisee files.

In addition to the representative sample in each relevant category, franchise due diligence should also include (at the very least) selecting certain franchisee files for a “deep dive” investigation. This involves reviewing the actual complete franchisee files for a certain number of individual franchisee locations and a certain number of years, including, for example, a review of: a copy of the actual franchise disclosure document (and any statements of material change) delivered to the franchisee; the franchise agreement and ancillary agreements (including any amendments to the standard template forms); the franchisee application file; any financial information or business plan provided and/or discussed with the franchisee; key correspondence; and any notices of default. The franchisee files chosen for review should reflect a strategic representative sample of the various categories of franchise arrangements in the relevant jurisdiction(s) (such as units that have been transferred, renewed, resold by the franchisor, regulated by franchise legislation, unregulated, etc.). These examinations will provide not only specific information about particular units, but will also provide insight about broader system processes and practices, including the target’s record keeping practices. The prospective purchaser should draw a negative inference of the target’s record keeping practices if the target is unable to produce complete files for each of its franchisees.

Finally, another approach to qualifying the scope of the due diligence is to restrict the investigation to issues that are of particular concern, and perhaps present the greatest risk, to the prospective purchaser. For example, instead of conducting a full review of documents and processes for any possible faults, diligence could instead focus on material issues that frequently give rise to litigation or the granting by courts of the two-year rescission remedy.[[7]](#footnote-8) Furthermore, the targeted diligence could look for any indicators of conflict in the franchise system and target particular areas of tension, such as the management of the advertising fund or the policies and practices related to the receipt, retention, and/or sharing of rebates. Some prospective purchasers might also be keenly interested in any franchise agreement provisions that present serious obstacles to making changes to the system post-closing, such as any franchisee consent requirements or the inability to require additional or replacement trade-marks. No system is without issue, but potential class actions or rescission claims are an example of important red flags for prospective purchasers. As with most aspects of due diligence, however, it is fundamentally important that the prospective purchaser and its counsel are aligned on what the lawyer will be reviewing and what issues will specifically be flagged for the client.

**(C) Major Contracts and Documents to Review**

As mentioned above, a franchise system is predominately comprised of a complex network of relationships, and with it, all manner of arrangements and agreements. Accordingly, it is no surprise that at the heart of franchise-specific due diligence is the review and analysis of franchise disclosure documents and franchise agreements (across all relevant jurisdictions). In addition, there are often key contracts related to intellectual property and the supply chain network that will be of significant importance. In the context of a unit franchise sale, the important elements of due diligence in this regard will be a review of any disclosure document provided by the franchisor to the prospective purchaser, if required by law, together with the proposed franchise agreement and any other agreements proposed between the franchisor and the prospective purchaser. If the prospective purchaser is buying shares in the franchisee entity operating the franchise unit, as noted above, the prospective purchaser may also wish to review the disclosure document of the selling franchisee to determine whether it will get the benefit of any existing rescission or misrepresentation claims against the franchisor.

**(i) Franchise Disclosure Documents**

Many franchise disclosure documents represent a miniature due diligence summary in themselves and cover a lot of the same issues that are typically addressed in a transactional due diligence process. In addition, in the context of a franchise system acquisition, franchise disclosure documents must be reviewed on the basis that they are one of the main sources of rescission and misrepresentation claims. In the context of a unit franchise sale, the franchise disclosure document, if one is required to be provided by law, is likely to be the dominant focus of due diligence review.

In the context of a franchise system acquisition, reviewing franchise disclosure documents that have been provided to franchisees will allow the prospective purchaser to begin identifying issues and areas of concern on matters such as corporate structure, management, system details, terminations and transfers, audited financial statements, litigation and bankruptcy, economic structure of the system, treatment of rebates, any involvement in financing, supply chain, intellectual property rights, and any earnings projections. In addition to reviewing the franchise disclosure documents themselves, the prospective purchaser must evaluate the franchisor’s disclosure processes and general record retention practices. This will allow the purchaser to get a better understanding of the franchisor’s approach to site-specific disclosure, currency of disclosure, the use of statements of material change, the provision of earnings projections (if any), record retention, and other general disclosure processes and practices. The prospective purchaser should also review the target’s marketing material to ensure that it is consistent with the information contained in the franchise disclosure document.

These reviews will reveal any deficiencies and the possible risks of rescission or misrepresentation claims. As discussed below, the risk of a rescission remedy or misrepresentation claim is a major red flag in considering an acquisition of a franchise system, and locating any material deficiencies or misrepresentations in franchise disclosure documents is of paramount importance for franchise-specific due diligence, and is essential when valuing a target franchise system and structuring the transaction to mitigate risk.

**(ii) Franchise Agreements**

The next critical documents to review and examine are the franchise agreements. In the context of a franchise system acquisition, it is important to distinguish, of course, between template franchise agreements (which may be revised from time to time) and any negotiated variations. The key provisions to be reviewed will vary depending on the target system’s business and the prospective purchaser’s plans for the system post-closing, as will be discussed below.

As a starting point, the prospective purchaser should confirm that the target has the ability to assign its rights and obligations under the franchise agreement and ancillary agreements to the purchaser without the requirement for franchisee consent. It is equally important for a prospective purchaser to review provisions dealing with term, renewal, and termination. Depending on post-closing intentions, the prospective purchaser may wish to review provisions dealing with system change, restrictions on franchisee transfers and assignments, protected territory, and reserved rights. Lastly, the prospective purchaser of a franchise system may wish to examine the enforceability of applicable law and non-competition or non-solicitation provisions. Naturally, different purchasers will have different priorities, but reviewing these provisions will allow a prospective purchaser to identify, among other things, any provisions that may impede the transaction, limit the prospective purchaser’s ability to grow or change the system post-closing in the way they want, or signal vulnerability to liability.[[8]](#footnote-9)

In the context of a unit franchise sale, the prospective purchaser must review all of the terms of the franchise agreement that will govern the relationship with the franchisor post-closing, as such terms will govern its ability to operate the franchised business. If the prospective purchaser is entering into the franchisor’s then-current form of franchise agreement rather than taking an assignment of the target’s existing franchise agreement, the purchaser should consider whether any different terms may have a negative impact on the prospective purchaser’s ability to continue operating the franchised business post-closing. For example, have fees and payments been increased, have renewal rights been limited, have termination rights become less palatable, have non-competition or non-solicitation provisions become more restrictive, etc.? Conversely, if the prospective purchaser is taking an assignment of the target’s existing franchise agreement, the purchaser should ensure that the remainder of the term granted under the franchise agreement, and any renewal rights, are sufficiently long and certain, to recoup the purchaser’s investment in the franchise.

**(iii) Other Major Franchise Concerns**

(a) Purchasing, Supply, and Distribution Contracts

Given the complexity of many franchise networks, there are other important contracts that surface regularly and deserve attention during the due diligence process. In particular, purchasing, supply, and distribution contracts are the lifeblood of many franchise systems, access to which is one of the marked benefits of joining the system. However, these contracts can be structured in many different ways and can be subject to variations based on product or geography. They can also address supplies as discrepant as consumer products, communications systems, marketing materials, and bookkeeping services. Given their crucial role in the functioning of the network, a prospective purchaser should inspect these contracts closely in order to make sure that they are viable and will remain so, they make economic sense, and they are assignable to the prospective purchaser. A good place to start is to request a list and summaries of all of the relevant contracts, after which the purchaser can perform a more thorough analysis.

(b) Intellectual Property

Another important set of contracts to review is the key intellectual property information and documentation relevant to the franchise network. This includes not only the well-known trademarks and logos familiar to consumers, but also any trade dress, confidential operating manuals, trade secrets, proprietary software, patents, and/or copyrights.

For each of these categories of intellectual property, the prospective purchaser will have to assess whether the franchisor owns the intellectual property including exactly what rights it holds in the property, whether it is licensed to others, whether it is subject to any restrictions, and whether it is freely assignable by the franchisor. It is also particularly important to verify that all critical intellectual property is properly registered with the Canadian Intellectual Property Office and that those registrations are not subject to any vulnerabilities.

As with the supply contracts, it is useful to request a list of all intellectual property and review all disputes (or potential disputes) relating thereto. The prospective purchaser needs to assure itself that the intellectual property it is acquiring—which is often of considerable value in the acquisition of a franchise system—is free from any limitations over its ownership, use, and assignability.

(c) Real Estate

It is important for a prospective purchaser to determine how real estate is handled within the franchise system. For example, does the franchisor own or lease any real estate that is in turn leased or subleased to franchisees? If so, can such real estate be assigned to the prospective purchaser without the requirement of consent? Alternatively, if the franchise agreements provide for the conditional assignment of a franchisee’s lease to the franchisor in the event of a termination, the prospective purchaser should evaluate the parameters of such provisions and what the franchisor’s rights and obligations are in the circumstances.

(d) Financing

A prospective purchaser should also be concerned with any financing a franchisor has provided to franchisees as well as any guarantees or security agreements backing such financing. Of particular importance is the need to confirm that any security interests held by the franchisor have been properly registered and have priority over other creditors. Furthermore, the prospective purchaser should determine if any franchisee loans have been allowed to default, as this may signal that the prospective purchaser may have difficulty collecting such amounts.

**(D) Key Issues**

As noted above, the main purpose of due diligence in franchise system acquisitions is to identify issues and concerns with which the prospective purchaser may seek to adjust the purchase price, institute changes pre- or post-sale, restructure the transaction to mitigate risk, or elect not to proceed with the purchase at all. With respect to franchise-specific due diligence in the context of franchise system acquisitions, some of the key issues to look for are deficiencies that indicate the existence of franchisee rescission rights or claims for misrepresentation, undesirable and obstructive provisions in franchise agreements, and material conflicts in the relationships inherent in the franchise system.

**(i) Franchise Disclosure Document**

(a) Rescission

In regulated provinces, the dominant red flag in any franchise due diligence process is the potential existence of a claim for the onerous two-year rescission remedy arising because of a lack of disclosure or because of materially deficient disclosure.[[9]](#footnote-10) At its simplest, this remedy exists where the franchisor fails to provide a franchisee with a franchise disclosure document. However, courts have increasingly held that certain deficiencies in disclosure documents are so material that even if a disclosure document has been provided, it ought not be considered a disclosure document at all, giving rise to the two-year rescission remedy.These deficiencies include failing to provide any of the following: correct financial statements; the disclosure document as a single document at one time; a copy of the head lease for the premises; the telephone numbers of existing franchisees; location closure information; the terms and conditions of indirect financial arrangements offered by the franchisor; a properly signed and dated franchisor’s certificate; statements of material change (where applicable); certain site-specific information; and statements justifying earnings projections (where applicable). In addition to reviewing franchise disclosure documents for these red flags, the franchise due diligence process should include an assessment of whether the franchisor has complied with the timing and delivery requirements for delivering disclosure documents, as such deficiencies will at a minimum give rise to statutory misrepresentation.

The existence of the two-year rescission remedy can have a significant impact on the value of the franchise system because of the potential of post-closing liability. In particular, in Ontario, if a franchisee is successful in making a rescission claim, the franchisor must (within 60 days of the date of rescission): refund to the franchisee any money received from or on behalf of the franchisee, other than money for inventory, supplies or equipment; purchase from the franchisee any inventory purchased pursuant to the franchise agreement at a price equal to the purchase price paid by the franchisee; purchase any supplies and equipment that the franchisee had purchased pursuant to the agreement at a price equal to the purchase price paid by the franchisee; and compensate the franchisee for any losses incurred in acquiring, setting up, and operating the franchise less the amounts of the purchase expended on the repurchase requirements.

In a share-based transaction, as the franchisor entity does not change, the purchaser will, in effect, inherit any post-closing rescission liability. In an asset-based transaction, a franchisee may attempt to bring a post-closing rescission claim against the target, the purchaser, or both. In both cases, the purchase agreement can be drafted to allocate the financial burden associated with any post-closing rescission liability to the target. As a result, where the existence of the two-year rescission remedy is discovered during due diligence, it will be important to assess the potential magnitude of the risk. In doing so, the prospective purchaser should attempt to ascertain whether the deficiency in question is specific to that particular franchisee, or whether it is a sign of a systematic problem. For example, discovering one franchise disclosure document out of 10 with an improperly signed franchisor’s certificate may be chalked up to an isolated mistake with that one particular disclosure document, but discovering that financial statements prepared to the wrong standard have been included in disclosure documents for an entire fiscal year could be a sign of a systematic problem. Once the risk has been assessed, the prospective purchaser should explore the risk’s impact on the transaction and how best to address it.[[10]](#footnote-11)

(b) Statutory Misrepresentation

Statutory misrepresentation claims should also be of specific concern to prospective purchasers. In regulated provinces, franchisees have access to a statutory remedy for damages if they suffer a loss due to a misrepresentation in the franchisor’s disclosure document or statement of material change, or as a result of the franchisor’s failure to comply in any way with the requirement to provide a disclosure document to prospective franchisees.[[11]](#footnote-12) The class of persons potentially liable under this misrepresentation claim is broader than it would be under the common law: in most regulated provinces, franchisees can exercise this right against the franchisor, the franchisor’s broker or associate, as well as every person who signed the disclosure document. In Ontario, that class is stretched even further to include agents of the franchisor.

Unlike the rescission remedy, the franchise legislation does not prescribe the specific categories of damages that a franchisee will be entitled to in the event of a misrepresentation, but rather the franchisee must prove actual losses incurred as a result of the misrepresentation. Having said that, while the ramifications of a statutory misrepresentation claim may not appear as draconian as a statutory rescission claim, some franchisee counsel have attempted to frame franchisee losses under a misrepresentation claim to end up being quite similar to the damages the franchisee would be entitled to under a rescission claim. It is also important to note that a claim for statutory misrepresentation is not limited by the same limitation period as the rescission remedy, but rather regular provincial limitation periods apply. For example, in Ontario, the basic limitation period in which an action may be commenced is two years from the earlier of the day on which the essential elements of the claim are known to the claimant and the day on which they are discoverable.[[12]](#footnote-13)

Similar to any liability from the potential existence of the rescission remedy, in a share-based transaction, as the franchisor entity does not change, the purchaser will, in effect, inherit any statutory misrepresentation liability post-closing. In an asset-based transaction, a franchisee may attempt to bring a post-closing misrepresentation claim against the target, the purchaser, or both. In both cases, the purchase agreement can be drafted to allocate the financial burden associated with any post-closing misrepresentation liability to the target. As a result, where the existence of liability for a claim of statutory misrepresentation is discovered during due diligence, it will be important to assess the risk, explore its impact on the transaction, and how best to allocate it between the purchaser and target.[[13]](#footnote-14)

**(ii) Franchise Agreements**

After the franchise disclosure documents, the next documents to examine closely for key issues is the collection of franchise agreements selected for review. Regardless of whether the agreements are template documents or negotiated variations, certain provisions (discussed below) will warrant significant attention, particularly with respect to the prospective purchaser’s plans for operating and expanding the franchise system post-closing.

(a) Term and Renewal Rights

The prospective purchaser must review the term provisions of the franchise arrangements. For example, the prospective purchaser may want to assess: (i) whether the length of the term is unusually high or low; (ii) whether the majority of franchisees are at the beginning or the end of their terms; (iii) whether the nature of the system is such that a large number of franchise arrangements will terminate at the same time; or (iv) whether any of the franchise agreements are evergreen. The prospective purchaser must also review any renewal provisions of the franchise agreements. For example, the purchaser may want to assess: (i) whether the number and/or duration of renewal options is unusually high or low; (ii) whether renewal is at the option of the franchisee or franchisor or automatic; and (iii) if renewal is at the option of the franchisee, whether franchisees can renew as of right or whether they must meet certain conditions. Lastly, the prospective purchaser should review the franchisor’s termination rights and any buyout provisions. The importance of each of these terms will differ depending on the franchise arrangements in the system. For example, if there are existing franchise arrangements that the prospective purchaser believes will hamper its contemplated growth plans, then shorter remaining terms on the relevant franchise agreements would be desirable. In contrast, if there are strong and favourable franchise arrangements, the prospective purchaser will be looking for longer term agreements.

(b) System Changes

Given the importance of system uniformity, the strength of a franchise system may depend on the franchisor’s ability to unilaterally modify the system to respond to market demands or changes during the term of the franchise agreement. Generally speaking, a franchise agreement will provide for system changes through amendments to the manual. However, it is preferable for the franchise agreement to expressly include a “system change” provision giving the franchisor broad rights to implement change. The prospective purchaser should review the franchise agreement to confirm whether the franchisor can make system changes and to determine any separate limitations on the franchisor’s ability to do so. Depending on the prospective purchaser’s plans, this review should also include an assessment of whether or how the statutory duty of good faith and fair dealing may prevent the prospective purchaser from implementing any proposed post-closing system changes, or what specific steps a prospective purchaser might have to take to implement such changes.

(c) Change of Control and Restrictions on Assignment

A key part of the diligence review is a review of the franchise agreements to determine whether the rights and obligations may be assigned to the purchaser and/or whether a change in control of the franchisor entity may occur without the franchisees’ consent. If the franchise agreements do not allow the target to freely assign the franchise agreements to the prospective purchaser and/or undergo a change of control, the target will need to obtain the franchisees’ consent to the transaction (or risk the transaction being challenged as null and void). In fact, many practitioners hold the view that franchisee buy-in is a prudent course of action whether or not formal consent is required.

Separately, and looking to the future, the prospective purchaser may also want to review any transfer or assignment restrictions imposed on franchisees under the franchise agreements. For example, most franchise agreements will limit the franchisee from transferring or assigning the franchised business without the franchisor’s consent and include certain conditions precedent that must be met by the franchisee and transferee in order to obtain such consent. The transfer and assignment restrictions may be an important restriction for a prospective purchaser, as they allow a form of control over the selection of future franchisees.

(d) Non-Competition and Non-Solicitation

Restrictions on competition and solicitation (imposed on franchisees) are important protections for franchisors, and therefore are important to the prospective purchaser of a franchise system. Well drafted franchise agreements typically include both in-term and post-term non-competition and non-solicitation covenants. However, the enforceability of such clauses depends on a number of factors. To determine the likelihood of enforceability, the prospective purchaser should review the non-competition and non-solicitation covenants to ensure that they are sufficiently limited in temporal and geographic scope, they are drafted with sufficient certainty, and the scope of prohibited activities is reasonable. Prospective purchasers should bear in mind that it is difficult to predict the enforceability of non-competition and non-solicitation provisions with exact certainty, as the analysis is factual and will depend on the circumstances of each case.

(e) Advertising Fund and Retention of Rebates

The franchisor’s administration of the advertising fund and its practices and policies related to the receipt, retention, and/or sharing of rebates are often sources of tension between franchisees and franchisors. Accordingly, the prospective purchaser should closely review any provisions in the franchise agreement dealing with the administration of the advertising fund and the treatment of rebates to gain a solid understanding of how these often contentious elements of the system are managed by the franchisor. The prospective purchaser may also consider auditing the target’s financial information related to the administration of the advertising fund and the treatment of rebates to determine whether the target is complying with the terms of the franchise agreement and whether any significant financial deficits (i.e., liabilities) exist. Alleged misuse of advertising funds and rebates have given rise to class-action lawsuits in Canada, and therefore any risk exposure in these areas should be of significant concern to a prospective purchaser. In addition, the prospective purchaser should compare the current approach to administering the advertising fund and rebates with its plans for the franchise system post-closing. Any impediments in this regard will potentially decrease the value of the target system from the purchaser’s perspective.

(f) Protected Territory and Reserved Rights

It will be important to review the target’s approach to granting franchise territories as well as any reserved rights in order to determine any restrictions on the prospective purchaser’s ability to manage and grow the system post-closing, particularly where the purchaser will be operating competing brands post-acquisition. For example, where the existing franchisor has granted exclusive territories, the prospective purchaser should determine: (i) how the boundaries of the territories are determined (e.g., geographic radius, boundaries, map, postal codes, etc.); (ii) the number and location of the territories that have been granted and whether there is any overlap; (iii) the extent (and the location, viability, etc.) of remaining territories; and (iv) whether the right to such exclusive territory is conditional on performance (or other requirements). Also important is a review and analysis of the rights that the target has reserved, both inside and outside the exclusive territories that have been granted to franchisees. For example, does the target have the right to operate or license others to operate within the exclusive territories: (i) through other channels of distribution; (ii) offering different goods or services under different trade-marks; (iii) offering competing goods or services under different trade-marks, etc.? This will be especially important where the prospective purchaser intends to operate (or potentially acquire) a competing brand post-closing.

**(iii) Relationships**

Another key issue to review and consider is the franchisor-franchisee relationships. These relationships are the foundation of the target’s business. As crucial stakeholders in a franchise system, the franchisees’ attitudes toward the franchise system as a whole, the existing franchisor, and the prospective purchaser provide a useful vantage point from which to evaluate the network. They may also provide clues into how the system will react to the prospective purchaser’s planned changes. Speaking with franchisees themselves may not be possible due to confidentiality restrictions in the letter of intent or purchase agreement, but valuable indirect information can be obtained. For example, reviewing franchisee files may reveal a high number of defaults, transfers, or terminations. This will be a significant red flag warranting further investigation. In addition, the mere existence of a franchisee association (formed by the franchisees) may be telling, given that they are usually formed on the basis of collective issues with the system. It is worthwhile reviewing the franchisee association files to discover the background of its existence together with current issues being addressed. Current conflict may not exist, but such associations are often formed in reaction to discontent. All franchisee complaints, whether via an association or not, should be identified, reviewed, and considered. This includes correspondence between the franchisor and troubled franchisees regarding general complaints, particularly where termination has been addressed or threatened. The prospective purchaser may also consider structuring the purchase agreement to allow the purchaser to conduct a franchisee survey to elicit direct information from franchisees about their attitudes toward the franchise system as a whole, the existing franchisor, and the prospective purchaser. The use of franchisee surveys should also contemplate the purchaser having the right to walk away from the transaction if the results (or a certain percentage of the results) of the survey are troubling. Identifying any “cracks” in the franchisor-franchisee relationships is important as they may have already impacted the viability of the system or could lead to further damage, litigation, defection, or, in extreme cases, an implosion of the entire system. At a minimum, such disputes can drain the resources of the prospective purchaser once it assumes the role of franchisor post-closing.

**(iv) Manual**

Lastly, the prospective purchaser should review the contents of the target’s operation manual. The operations manual is the heart of the target’s business and contains information essential to the prospective purchaser’s initial and ongoing operations of the franchise system.

**III. Mitigating and Allocating Risks**

Risks are inherent in any transaction; the purchase and sale of a franchise system or single unit franchise is no exception. However, a prospective purchaser, whether acquiring an entire franchise system or a single franchise unit, can take steps to mitigate certain risks and also allocate certain risks between it and the target. While appropriate due diligence on the target entity and the business assets, as described above, is a major part of mitigating the risks associated with purchasing a franchise system or single unit franchise, there are a number of additional ways to mitigate and allocate risk.

**(A) Structuring the Transaction**

Selecting the right structure is one way a prospective purchaser can mitigate risk. For example, should a prospective purchaser purchase the assets or shares of the target or its holding company? The answer is, as in many cases: it depends. There are a number of considerations that will factor into the best structure for a particular transaction. While not an exhaustive list, the following are some of the key considerations for a target and prospective purchaser when deciding how best to structure the transaction.

First, the shareholders of a target franchise system may wish to structure the transaction as a share purchase transaction in order to take advantage of the lifetime capital gains exemption (indexed to inflation) that is available to Canadian residents who sell shares of a qualified small business corporation. A prospective purchaser may similarly be in favour of a share purchase transaction in order to take advantage of the target’s non-capital tax-loss carryforwards (i.e., business losses) that can be applied against future income, and to avoid the payment of certain sales and property transfer taxes.

Second, when considering the transaction structure from a liability perspective, a prospective purchaser may prefer an asset purchase transaction as it allows the prospective purchaser the opportunity to hand pick the assets and the liabilities that it will acquire. More importantly, an asset purchase transaction generally shields the prospective purchaser from any unknown liabilities that may surface post-closing. However, limiting liability by way of an asset purchase transaction is subject to a number of exceptions. For example, liability associated with employment standards, labour relations, bulk sales, personal property security, and environmental laws. An asset purchase transaction may be particularly attractive to a prospective purchaser where rescission and misrepresentation liabilities have been identified during the due diligence process. However, while this issue has not been expressly dealt with by franchise legislation, franchisees may still attempt to bring rescission and misrepresentation claims against a prospective purchaser post-closing, notwithstanding the asset purchase nature of the transaction.

Third, share-based transactions can be less complex than asset-based transactions in that all that pertains to the target’s business and assets is neatly transferred through the shares of the target corporation. In an asset-based transaction, the prospective purchaser and the target will need to identify and address in the purchase agreement all of the assets and liabilities that are being purchased. In addition, in an asset-based transaction all of the relevant contracts being transferred will need to be assigned to the purchaser; in a share-based transaction, this is done automatically by virtue of the share purchase.

**(B) Purchase Price, Holdback, and Rectification Steps**

Depending on the issues that were identified during due diligence, a prospective purchaser may choose to mitigate its risk by negotiating a reduction of the purchase price to reflect a lower value because of the risk, and to reserve cash that can be applied against potential liabilities arising post-closing. In addition, the prospective purchaser may choose to mitigate its risk by negotiating that a certain portion of the purchase price be held back and placed in escrow for a certain period of time, to be used as a reserve of funds from which to make an indemnity claim. The amount of the holdback and the length of the escrow will depend on the risks identified during the due diligence process. For example, if a number of rescission claims are identified, the prospective purchaser may wish to quantify such claims and use the amount determined as the basis for the holdback. In some cases there may be multiple holdback amounts with staggered payment schedules.

Another approach may be to require the target to undertake a number of pre-closing rectification actions. For example, where the intellectual property rights of the target have not been appropriately protected (e.g., through registration), the prospective purchaser may require the target to put in place the appropriate protections as a condition precedent to signing the purchase agreement or closing the transaction. However, it is worth noting that rectification work is not always straightforward. For example, rectification work may not be appropriate where a prospective purchaser has identified the potential for several rescission claims during the due diligence process. In such circumstances, the franchisees with these rescission claims may not be aware that they have a claim, and attempts to rectify such claims would alert the franchisees and could cause a number of issues for the target and prospective purchaser, for example: the franchisees could refuse to settle the claim and reserve their right to bring the claim in the future or the franchisees could use the claim as leverage for more favourable terms on a new franchise agreement or to derail the transaction. In addition, it is worth noting that some franchise practitioners take the position that it is extremely difficult to rectify a rescission claim and others take the position that it is not possible. Accordingly, a prospective purchaser should be aware that any attempts to rectify rescission risk will always be subject to a great deal of risk.

In addition to the rectification work that a prospective purchaser can require a target to undertake, the prospective purchaser can perform an analysis on certain known risks that cannot be rectified. For example, if there are a number of franchise arrangements that are ending in the near term, the prospective purchaser may consider modelling the economic impact of franchisees that choose not to renew and the time it will take to replace such franchisees. The prospective purchaser can use existing information regarding turnover and the rate of new franchise sales to construct the model and then consider the potential outcomes. This kind of analysis will further inform the prospective purchaser as to whether the deal makes sense.

In the case of purchasing a unit franchise, a prudent approach to mitigating risk includes arranging a meeting with the franchisor to discuss the proposed transaction and the franchisor’s opinion on the current operations and potential improvements (e.g., new products and services) of the unit franchise. Such a discussion can provide valuable guidance for the prospective purchaser in determining the potential for the location. However, prospective purchasers should note that franchisors may not be willing to engage in such discussions as they might increase the franchisor’s disclosure obligations.

**(C) Representations and Warranties**

One of the primary ways to mitigate and allocate risk in a transaction is through the use of representations and warranties, together with corresponding covenants and indemnities, in the purchase agreement. The use of representations and warranties is particularly important for risks that relate to uncertainties (e.g., future potential litigation based on previous actions of the target) as the prospective purchaser will want to insulate itself from any potential liability associated with such risks. Accordingly, a representation and warranty that there are no known causes of action, or circumstances that could lead to same, will allocate the risk of an unknown cause of action to the target. However, the approach to the use of representations and warranties is different when it comes to risks that relate to known deficiencies. In these circumstances, the typical approach is to carve out any known deficiencies from the representation and warranty. For example, in the case of non-compliance with franchise disclosure requirements discovered during the due diligence process, the representation and warranty may be structured along the following lines:

1. Except as may otherwise be set out herein, and without limiting Section ⚫, each of the Seller Parties has complied with all applicable Franchise Laws. In particular, without limiting the foregoing:

(a) except for the franchise disclosure documents delivered in connection with the grant of those Franchised Businesses listed in Schedule ⚫, each of the Seller Parties has complied with all applicable obligations under applicable Franchise Laws to deliver to Franchisees a franchise disclosure document, including to new, renewing and transferee Franchisees;

…

As already stated, mergers and acquisitions of franchises and franchise systems involve a number of unique matters due, in part, to the regulatory environment that governs franchising in certain Canadian provinces. Accordingly, drafting franchise-specific representations and warranties includes addressing compliance with these franchise laws.

There are a number of approaches to drafting franchise-specific representations and warranties. However, generally speaking, the more specific the representations and warranties, the better protection they afford the prospective purchaser. For example, a representation and warranty addressing compliance with franchise laws could begin with a general statement of compliance and then extend to specifically address the obligations of the franchisor to conduct itself in good faith, not interfere with franchisees’ right to associate, and comply with all disclosure obligations. This type of representation and warranty may be structured along the following lines:

1. Except as may otherwise be set out herein, and without limiting Section ⚫, each of the Seller Parties has complied with all applicable Franchise Laws. In particular, without limiting the foregoing:

(a) except for the franchise disclosure documents delivered in connection with the grant of those Franchised Businesses listed in Schedule ⚫, each of the Seller Parties has complied with all applicable obligations under applicable Franchise Laws to deliver to Franchisees a franchise disclosure document, including to new, renewing and transferee Franchisees;

(b) no Franchisee has made any Claim that any of the Seller Parties has failed to deal with a Franchisee fairly, in good faith and in accordance with reasonable commercial standards in the performance or enforcement of each Franchise Agreement or in the exercise of any right or discretion under each Franchise Agreement;

(c) none of the Seller Parties have interfered with, prohibited or restricted, by contract or otherwise, a Franchisee from forming or joining an organization of franchisees or from associating with other franchisees, nor have any of the Seller Parties penalized, attempted to penalize or threatened to penalize a Franchisee for doing so;

…

In addition to the addressing the foregoing obligations, a prospective purchaser may wish to include a detailed representation and warranty related to the franchise sales process. For example, the representation and warranty would cover, among other things, that: (i) no misrepresentations were made by the target’s sale staff, agents, or associates; (ii) no earnings projections were provided except pursuant to the franchise disclosure document (and in accordance with prescribed requirements); (iii) franchise disclosure documents have been prepared strictly in accordance with applicable franchise laws; (iv) that all franchise disclosure documents included properly signed and dated certificates; and (v) all time frames required by franchise laws were complied with in selling franchises.

As noted above, the franchisor’s administration of the advertising fund and treatment of rebates can be sources of much frustration in the franchisor-franchisee relationship. Accordingly, it is important for a prospective purchaser to address these matters in robust representations and warranties to allocate risk appropriately. This type of representation and warranty may be structured along the following lines:

2. Without limiting Section ⚫, there are no Claims, investigations or other proceedings, including appeals and applications for review, in progress, or, to the knowledge of the Seller Parties, pending or threatened against or relating to the Seller Parties in relation to any Franchise Agreement, Franchised Business franchise disclosure document or statement of material change, including:

(a) the receipt, use and accounting of rebates, discounts and/or allowances received by the Seller Parties based on purchases made by Franchisees;

(b) the receipt, use and accounting for advertising, marketing or promotional funds received by the Seller Parties from Franchisees;

…

With respect to the administration of the advertising fund, the prospective purchaser may also consider getting a representation and warranty that covers, among other things, that: (i) the target has provided the prospective purchaser with all information and records pertaining to the administration of the advertising fund; (ii) the advertising fund has been operated in a manner that is consistent with the franchise agreements and applicable franchise laws; (iii) there are sufficient funds in the advertising fund to meet ongoing obligations of the advertising fund; (iv) the target owns all of the advertising and marketing materials; and (v) all arrangements with third parties involved in the administration of the advertising fund are in good standing. With respect to the retention and sharing of rebates, the prospective purchaser may also consider getting a representation and warranty that covers, among other things, that: (i) the target has disclosed to the prospective purchaser all of the information and records pertaining to the retention and sharing of rebates; (ii) the target has complied with any disclosure obligations to franchisees related to the retention and sharing of rebates; and (iii) the target has collected and dealt with rebates in a manner that is consistent with the terms of the franchise agreements and applicable franchise laws.

Lastly but not exhaustively, in addition to the foregoing, a prospective purchaser may wish to include representations and warranties regarding the following issues: (i) true and complete copies of all franchise agreements have been made available to the prospective purchaser; (ii) all franchise agreements are consistent, and to the extent that they are not, such variations have been clearly disclosed to the prospective purchaser; (iii) except as disclosed to the prospective purchaser, there are no amending agreements, side letters, or other arrangements affecting the terms of the franchise agreements; (iv) the franchise agreements are valid, binding, and enforceable, subject to the usual enforceability qualifications as well as franchise-specific qualifications, such as franchise legislation; (v) franchisees are not in breach of any provisions under the franchise agreements, including no over-holding franchise arrangements; (vi) there are no encroachment issues as between the franchisees; and (vii) the execution and delivery of the purchase agreement, and the transactions contemplated under it, is not inconsistent with any provision of the franchise agreements.

**(D) Indemnities**

As alluded to above, the representations and warranties included in a purchase agreement must be supported by appropriate covenants and indemnities. For example, the purchase agreement will commonly include the following types of indemnities in favour of the prospective purchaser: (i) indemnification for any loss arising out of a breach of a representation, warranty, or covenant; (ii) indemnification for any and all tax liabilities that relate to the period during which the target operated the business; (iii) indemnification for any other liabilities that have not been disclosed in the financial statements (or otherwise accepted by the purchaser) that relate to the period during which the target operated the business; and (iv) any litigation that relates to the period during which the target operated the business. In addition to these commonly included indemnities, the prospective purchaser may wish to include franchise-specific indemnities for additional protection. For example, the prospective purchaser may insist on an indemnity regarding the franchise-specific representations and warranties as well as any known deficiencies that were carved out of such representations and warranties.

The purchase agreement must also include the mechanics and conditions for how and when an indemnity claim can be made against the target. For example, which parties will provide the indemnities, how long will the indemnity survive post-closing, will the indemnity be subject to a monetary cap, what role will each party play in the defence of any litigation, etc.? It should be noted that the approach to the mechanics and conditions may differ depending on the nature of the indemnity. For example, a prospective purchaser may take a different approach depending on whether the indemnity relates to representations and warranties on general contract matters, tax matters, environmental matters, or franchise matters. The two most heavily negotiated indemnity mechanics and conditions relate to which parties will provide the indemnities and how long the indemnities will survive post-closing.

With respect to which parties will provide the indemnities, the prospective purchaser should consider whether the indemnity should come from the target alone or whether certain shareholders will also be required to provide indemnities. The rationale for extending the indemnity to shareholders is to protect the prospective purchaser from the situation where the target transfers all of its assets post-closing, thereby making it impossible for the prospective purchaser to collect on the indemnity. However, extending the list of indemnifiers to include shareholders is not a complete answer to this problem as nothing prevents such shareholders from also transferring their assets post-closing. For this reason, as discussed above, many prospective purchasers will require that a portion of the purchase price be held back and paid at a later time post-closing.

The time period in which an indemnity claim can be made is sometimes a heavily negotiated matter. For indemnities related to representations and warranties on general contract matters, the shortest period is typically 6 months and the longest period 2 years. However, for indemnities related to non-general contract matters, there are varying time frames used depending on the classes of representations and warranties they relate to. For example, the indemnity related to representations and warranties on fundamental matters (e.g., corporate authority to enter into the transaction, good title to the assets being transferred, etc.) can be stated to survive indefinitely. Another example of an indemnity attracting a longer time period is an indemnity related to representations and warranties on important target-dependent matters (e.g., tax liability, environmental liability, etc.).

With respect to indemnities related to franchise-specific representations and warranties, a prospective purchaser should ensure that the time period adequately covers the potential claims identified (e.g., a 2 year period for rescission claims and an even longer period for misrepresentation claims). In addition to time period, there are other mechanics around indemnity claims, such as liability caps, deductibles, and baskets that determine the extent of the target’s liability both in absolute dollar terms and per indemnity claim, but these topics are beyond the scope of this paper.

**IV. Best Practices for Franchise Compliance**

**(A) Proactive Due Diligence**

A prospective target will likely achieve a higher purchase price and experience smoother negotiations on a sale transaction where it has conducted proactive due diligence on its own franchise system. The prospective target’s professional advisors will often assist and coach the target in undertaking this process and preparing for a sale. However, the prospective target should be aware that this preparatory process can take months, even years. Accordingly, a prospective target that has already conducted proactive due diligence on its own franchise system can usually get to market more quickly than prospective targets that have not undertaken such diligence.

In simple terms, proactive due diligence essentially involves the target taking a best practices approach to its franchise system. For example, putting in place processes and practices for ensuring compliance with applicable franchise laws and maintaining accurate and detailed records of all franchise-related documentation is a great example of proactive due diligence. With the franchise arrangements being the central focus of the franchise system, prospective targets will want to ensure that they can demonstrate to a prospective purchaser that there has been demonstrable compliance with franchise laws.

In terms of putting in place processes and practices for ensuring compliance with applicable franchise laws and maintaining accurate and detailed records, the prospective target should ensure that all team members are trained and understand the legal requirements related to franchising. In addition, the prospective target should ensure that all franchisee files include clear records of the date on which disclosure documents were provided, preferably with certificates of receipt, copies of the actual documents provided, etc. The franchise arrangements that exist should also be properly documented and organized in franchisee files. Furthermore, it is prudent to keep a record of the different versions of franchise agreements that have been signed over the life of the franchise system, the variations made to the “template” versions, and charts and summaries as to the exclusive areas granted in various jurisdictions. The more processed information and analysis that a prospective target can provide to a prospective purchaser to make the due diligence easier, the better bargaining position the target will have.

**(B) Target Optimization Practices**

Due diligence, especially in the franchise context, will usually uncover issues of varying severity. However, a prospective target can do a number of things to potentially improve the value of the system and the target’s own position in a future transaction. These practices include developing an exit plan, enhancing the growth potential, complying with all relevant laws, and addressing anticipated issues well before any purchase negotiations.

One of the first steps for a prospective target is to develop an exit plan, which includes a determination of the best time to sell. There will be many factors that impact the optimal time to sell a franchise system. For example, if the franchise system is underperforming, it may make more sense to recapitalize or simply attempt to rebuild earnings before launching sale negotiations. Similarly, if the franchisor is party to a number of ongoing lawsuits, settling those litigation matters (and, to the extent possible, correcting the issues that gave rise to the litigation in the first place) will increase the appeal and value of the franchise system. Furthermore, if external forces like major economic changes are impacting the value of the franchise system, it may make more sense to delay a sale until such external forces are no longer in play.

A further important step is to enhance the growth potential of the franchise system. There are many ways to enhance the growth potential of the franchise system, such as: structuring and/or restructuring the system to eliminate protected territories and/or expand reserved rights; strengthening the franchisor’s contractual rights to make system changes; and ensuring term, renewal, and termination rights provide the franchisor with enough flexibility to frequently update its form of franchise agreement and eliminate underperforming franchisees.

Maintaining compliance with all relevant laws is one of the most important, if not the most important, steps in optimizing the value and appeal of a franchise system. As discussed above, prospective purchasers will be conducting extensive due diligence of the target to uncover, among other things, legal non-compliance and related risk. Accordingly an existing franchisor looking to achieve the highest possible value for the sale of its system ought to establish processes and adopt best practices to ensure compliance with all relevant laws and minimize this risk. In particular, the franchisor should create a standardized process for maintaining, updating, and issuing franchise disclosure documents so as to avoid major deficiencies that may give rise to the two-year rescission remedy. Franchisors should educate every member of the franchise team about the core franchise legislative requirements (i.e., disclosure obligations, duty of good faith and fair dealing requirements, and the right to associate). Finally, robust record retention practices are critical in establishing compliance with all relevant laws, particularly as they relate to franchise sales and the issuance of the franchise disclosure documents. The use of checklists and questionnaires are often helpful in establishing standardized processes and practices and ensuring compliance with all relevant laws.

A final step involves considering and addressing anticipated issues well before any sale and purchase negotiations begin. As discussed above, this may involve delaying a sale due to the underperformance of the system, the existence of ongoing litigation, or major economic changes. In addition, the prospective target may need to address any systematic franchisee concerns that could become litigious in the future, such as discontent with: the approach to the administration of the advertising fund; the receipt, retention and sharing of rebates; system changes; etc. In extreme situations, the anticipated issues may suggest the institution of a voluntary conversion program to bring franchisees on to a new form of franchise agreement where the original form is rife with issues and uncertainties.

As mentioned above, due diligence is one way in which a prospective purchaser attempts to appreciate—and ultimately mitigate—risk in a prospective acquisition. Establishing a transparent, smooth, and legally compliant operation, and anticipating purchaser concerns, will go a long way towards minimizing the risk impression and maximizing the franchisor’s sale value.

**V. Conclusion**

The purchase of a franchise unit and the purchase of entire franchise systems, while vastly different in themselves, both share unique aspects as compared to general business acquisitions. In order to correctly assess the value of the franchise unit or the franchise system as a whole, it is critical to understand the franchise business model, the intangibles which comprise the lion’s share of its assets, the complex relationships between the various layers of stakeholders, and the regulatory landscape. This understanding informs the approach and scope that ought to be taken with respect to due diligence, as well as the particular information and documentation that must be reviewed and analyzed. Moreover, it informs the prospective purchaser of the key issues that it should be looking to identify. All this leads to mitigating and allocating the risks associated with the franchise system or unit through pre-transaction rectification work and modification of the sale terms in the purchase agreement. Finally, knowledge of the unique aspects of a franchise system will assist existing franchisors better prepare themselves for the eventual exit from their businesses.

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1. The authors wish to thank Lucas Versteegh, articling student at Osler, Hoskin & Harcourt LLP, for his invaluable contributions to this paper. [↑](#footnote-ref-2)
2. Christine Jackson is a Senior Associate in the Franchise & Distribution Group at Osler, Hoskin & Harcourt LLP with extensive experience in advising purchasers and sellers in connection with the purchase and sale of franchise systems.

   [↑](#footnote-ref-3)
3. Andrae Marrocco is a Partner in the Toronto office of Dickinson Wright LLP. Andrae’s practice areas include Corporate M&A, Franchise & Distribution, and International Transactions. [↑](#footnote-ref-4)
4. The five provinces are, in chronological order, Alberta, Ontario, Prince Edward Island, New Brunswick, and Manitoba. Note that British Columbia’s Bill 38-2015, Franchises Act, received Royal Assent on November 17, 2015 and will come into force on February 1, 2017. [↑](#footnote-ref-5)
5. *See* **Key Issues** below. [↑](#footnote-ref-6)
6. *See* **Mitigating and Allocating Risks** below. [↑](#footnote-ref-7)
7. *See* **Key Issues** below for a discussion of material deficiencies and rescission claims. [↑](#footnote-ref-8)
8. *See* **Key Issues** below. [↑](#footnote-ref-9)
9. Franchisees also have a right to rescind the franchise agreement within 60 days of receiving the franchise disclosure document if (i) the franchisor does not provide a disclosure document or statement of material change within the time requirements, or (ii) the contents of the disclosure document do not meet the legislative criteria. While still worth noting, the shorter time scale of this remedy makes it less of a concern. However, deficiencies in disclosure—regardless of the remedy—are always material to a buyer, as they can be indicative of improper disclosure practices. [↑](#footnote-ref-10)
10. *See* **Mitigating and Allocating Risks** below. [↑](#footnote-ref-11)
11. Under Section 1(1) of the Ontario *Arthur Wishart Act* *(Franchise Disclosure), 2000*, S.O. 2000, c. 3, a “misrepresentation” includes an untrue statement of a material fact or an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made. [↑](#footnote-ref-12)
12. Note that there are a number of exceptions to the basic two-year rule. [↑](#footnote-ref-13)
13. *See* **Mitigating and Allocating Risks** below. [↑](#footnote-ref-14)