Negotiating Critical Representations and Warranties in Franchise Mergers and Acquisitions—Part II

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Franchise systems present a valuable investment proposition for both strategic and financial purchasers. Entrepreneurs seeking out their next business venture, manufacturers in need of a distribution network for their products or services, and competitors looking to take advantage of synergies, economies of scale, expanded offerings, or growing market share—in each case—can achieve those investment goals through the acquisition of a franchise system. Private equity firms are attracted by the robust, diversified, and continuous royalty streams; the proven (often internationally) business model; the potential for organic and rapid growth (without significant capital investment); and the goodwill and strength of an established brand that franchise systems can provide.

As posited in Part I of this article,[1] franchise M&A has become increasingly popular and sophisticated over the past decade, a trend that looks likely to continue. Moreover, franchise M&A transactions involve unique considerations that are relevant from initial strategy discussions, to the letter of intent and due diligence stages, through to the drafting and negotiating of the transaction documents. The terms of an M&A deal are laid out in the cornerstone document commonly referred to as the purchase agreement (irrespective of the underlying stock or asset purchase transaction). This article continues (from Part I) the focus on critical considerations that will ultimately shape the terms of the purchase agreement.

Part I includes a general discussion about representations and warranties, their purpose and use (e.g., in allocating risk), and the current seller-oriented market in which parties find themselves. Specific considerations and repre-

1. Andrae Marrocco, *Negotiating Critical Representations and Warranties in Franchise Mergers and Acquisitions—Part I*, 36:1 FRANCHISE L.J. 107 (2016).

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sentations come into play when dealing with particular industries and market segments, such as the franchise sector. Part I develops the notion of a franchise system as a complex web of relationships among suppliers (which provide the necessary inputs for the business); franchisors (which establish and monitor the business model); and franchisees (which deliver the products and services to the consumer). The most intricate part of the web is the unique franchisor-franchisee relationship that is based on a comprehensive interdependence. Special attention must be paid to this complex web of relationships from the outset, and particularly during the due diligence phase of an M&A deal, because a number of issues and deficiencies often surface during proper due diligence of a franchise system.[2] Not only is the franchise business model unique, but in many jurisdictions it is also regulated by specific franchise laws. Strategy and analysis of these matters leads to the inclusion of specific representations and warranties in the purchase agreement to address the issues and deficiencies.

Part II is split into three parts: (1) a discussion of additional best practice principles (continued from Part I) that apply in drafting representations and warranties, (2) an exposition of further select representations and warranties (also continued from Part I) and how they are crafted from the unique considerations that apply in franchise M&A transactions, and (3) further considerations for dealing with foreign jurisdictions and certain matters specific to Canada.

Finally, even though Part I and Part II of this article have been written predominantly from the perspective of a prospective purchaser (negotiating and drafting representations and warranties in the franchise M&A context), the author hopes that sellers will also benefit from the discussion and analysis.

I. General Best Practices

When it comes to drafting representations and warranties in the franchise M&A context (and in some cases generally), a number of best practice principles apply. Continuing from Part I, some of the more critical ones are set out below:

A. *What Is a "Franchise Agreement"?*

Franchise agreements and "arrangements" are the cornerstone of the franchise system. The representations and warranties dealing with franchise agreements (as detailed in Part I) can be undermined by a narrow or poorly drafted definition of "franchise agreements." This term should be defined in a broad enough way so as to capture all sorts of permutations of franchising, including joint ventures, partnerships, and alternative licensing arrangements. At the same time, care must be taken to ensure that an expanded def-

2. Barry Kurtz, *Digging into Franchises*, 16:4 BUS. L. TODAY (Apr. 2007), http://apps.americanbar.org/buslaw/blt/2007-03-04/kurtz.shtml.

inition interacts appropriately with the relevant representations and warranties. An alternative (more detailed) approach is to bifurcate the definition such that "franchise agreements" comprises only those typical agreements, and "franchise arrangements" includes the broader categories of franchise arrangements referred to above. Finally, whichever approach is adopted, the definitions should cover undocumented arrangements (e.g., where one or more franchisees are holding over or where certain arrangements were never documented). Having said that, undocumented arrangements should also be dealt with by other means (e.g., with a condition to closing that they be negotiated and documented).

B. *General vs. Specific*

There are differing schools of thought on whether representations and warranties should be general (avoiding duplication and verbosity) or whether overlapping and more specific representations and warranties addressing similar subject matter are preferable (striving for better protection). A general catchall "compliance with laws" representation and warranty may, in some cases, be sufficient to address all areas of regulatory compliance. In other cases, (1) the representation and warranty may need to be shaped to reflect particular compliance aspects (e.g., franchise specific legislation in which specific elements of compliance need to be emphasized); (2) negotiated carve outs or qualifiers may be entirely unacceptable for all elements of a general representation and warranty (e.g., a purchaser may resist the application of a materiality qualifier on strict compliance with franchise specific legislation, but may be amenable to such qualification on compliance with all other applicable laws); and (3) additional comfort may be required or desired by a party, and for business reasons it may be important to include a specific representation and warranty separately (e.g., compliance with franchise laws of a particular jurisdiction that has a unique approach to regulation).

C. *Watch Overlap and Inconsistency*

The corollary of the above is that purchasers should be circumspect and avoid crafting and negotiating overlapping and inconsistent representations and warranties. This scenario can lead to ambiguity and confusion and potentially less protection for the purchaser (i.e., in circumstances where a court is required to interpret the meaning of two conflicting representations and warranties). Such conflict can arise, for example, where purchase agreements include more than one representation and warranty dealing with "compliance with laws," e.g., general laws, tax laws, real property laws, and franchise laws. Purchasers should ensure that in circumstances of overlap, one provision does not detract from the other through inconsistent qualifiers or other limiting language. Protective language, such as "in addition to and without derogation from section X . . . ," can be useful, but its utility can be limited where multiple sections deal with the same subject matter. Includ-

ing a *contra proferentem* provision may also afford some protection for the drafting party, but should not be relied upon to remedy loose drafting.

D. *Rectify Before You Close*

Certain deficiencies are best rectified either up front before negotiating and signing a purchase agreement or during the interim period (after signing, but prior to closing). Parties should not attempt to force a square peg in a round hole by including in the representations and warranties issues that should be appropriately addressed before finalizing the business deal. For example, with respect to registration of intellectual property, some purchasers will insist that all rectification work be undertaken before entering into purchase agreement negotiations. Alternatively, the rectification work may be included in the purchase agreement as a covenant (requiring the seller to undertake the specific work) with a corresponding condition to closing. Relying on post-closing covenants to undertake such work not only puts the purchaser in a weaker position (e.g., vis-à-vis recourse), but also exposes the purchaser to additional risk and potential liability (e.g., not being able to realize its expansion plans).

E. *Sandbagging*

Sellers will sometimes look to limit the ability of the purchaser to pursue an indemnity claim for breaches, defects, or liabilities that the purchaser was aware of prior to the closing of the transaction ("anti-sandbagging"). Conversely, purchasers will look to protect themselves from such limitations by including "pro-sandbagging" provisions permitting them to pursue an indemnity claim (post-closing) notwithstanding knowledge of any breach, defect, or liability prior to the closing of the transaction. If a purchaser compromises on this point, the "knowledge" of the purchaser should be carefully defined and limited. For example, some purchasers will agree to an anti-sandbagging provision provided that knowledge of breaches, defects, or liabilities is limited to the "actual" knowledge of specific individuals or classes of individuals, e.g., senior management responsible for managing the business, negotiating the purchase agreement, or both. The onus of proving knowledge in any case can be quite cumbersome. Accordingly, some sellers and purchasers limit the scope of knowledge to the information contained in the data room, which is then maintained post-closing for future reference.

F. *Franchise Disclosure Documents*

From the perspective of learning about the franchise system, franchise disclosure documents are an integral part of the due diligence undertaken by a prospective franchisee when considering the purchase of a franchise unit. The approach to franchise disclosure documents in the franchise M&A context is significantly different for a number of reasons. First, the purchaser of a franchise system will require much more information about the franchise system than the prescribed information contained in franchise

disclosure documents. For example, the list of court proceedings described in franchise disclosure documents may be a good starting point. However, not all litigation in which a franchisor or its affiliates are involved will necessarily be listed in the franchise disclosure document. Under various provincial franchise statutes in Canada, only certain types of litigation must be disclosed, e.g., litigation regarding allegations of fraud or failure to comply with the statutes.[3] Accordingly, the franchise disclosure document cannot be relied upon to be conclusive on all subject matter contained in it. Second, the veracity and completeness of the franchise disclosure documents may be an issue. Purchasers in fact should conduct due diligence on the franchise disclosure documents including an assessment of the veracity and completeness of statements made; confirmation of jurisdiction specific compliance, e.g., registration in the relevant states; and appropriate delivery to prospective franchisees.

II. Drafting Representations and Warranties

Turning to a review and analysis of the unique critical considerations that should be addressed in acquiring a franchise system, and how representations and warranties can be crafted to address those considerations, it should be noted that:

(1) the unique considerations selected for discussion, while critical from the author's perspective, are not intended to be exhaustive of all matters that should be addressed;

(2) Part I of this article addresses a further set of unique considerations;

(3) the discussion, analysis, and model representations and warranties are intended to stimulate thought and to provide insight and guidance on the unique considerations that apply to franchise M&A transactions;

(4) in the current seller's market, purchasers often make numerous compromises on representations and warranties;

(5) although only a handful of critical considerations are discussed, it is intended that the methodology, rationale, and tools of analysis used (and suggestions on how to deal with them) can be extrapolated to others;

(6) the discussion and analysis of representations and warranties apply, for the most part, whether the transaction is an asset or stock transaction;

(7) the discussion and analysis of representations and warranties relate specifically to transactions involving U.S. and Canadian franchise systems (although they may be applicable beyond that), but do address global transactions in certain aspects; and

3. Café Demetre Franchising Corp v 2249027 Ontario Inc., 2015 ONCA 258.

(8) the focus is on negotiating the representations and warranties (provided by the seller to the purchaser of an entire franchise system) from the purchaser's perspective.

The value of a franchise system is found in its intangible assets.[4] These assets, discussed further below, are broadly categorized as intellectual property and associated goodwill, key relationships, material contracts, and human capital. In any franchise M&A transaction, the process must reflect an appreciation of, and place a degree of focus on, these assets in the context of the franchise business model. The representations and warranties negotiated into the purchase agreement should be similarly focused.

A. *Management and Compliance*

Running a successful franchise system involves good management of franchise units and consistent implementation of compliance measures. Purchasers spend a good deal of time conducting due diligence and specifically reviewing and assessing how franchisors identify and deal with non-compliance issues in their system. Franchisee files are a rich source of information that can inform the purchaser as to the conduct and approach the franchisor has taken in this regard. Avoiding full-blown disputes over non-compliance issues is desirable, but a laissez faire approach to enforcing standards weakens the franchise system. For example, if franchise units are late with or dismissive of store upgrades and enhancements, the goodwill and allure of a brand may be weakened for the whole system. This is an area where comprehensive due diligence and appropriate closing conditions with respect to rectification and enforcement of system standards serve the purchaser well.

Management and compliance representations and warranties should be included in the purchase agreement to deal with certain unknown matters, particularly where only a select pool of franchisees has been assessed in due diligence. This representation usually states that franchisees are in substantial compliance with all of the requirements of the franchise system—and that franchisees are operating their franchise businesses in accordance with the franchise (and related) agreements, as well as the operations manual and system standards. The representation typically includes a statement that such standards have been maintained and enforced by the franchisor consistently and in an appropriate manner. If possible, a better approach is to include a representation and warranty that references the franchisor's policies and procedures and attests to compliance with those particular policies and procedures. Where a franchisor seller seeks to qualify the representation and warranty with certain exceptions (as is customary and advisable for sellers to do), purchasers should attempt to have the seller remedy at least the serious deficiencies. Clearly, if the deficiencies relate to incomplete physical store upgrades, completion is not likely to take place prior to closing.

4. Richard G. Greenstein & Joel Buckberg, *The Basics of Buying and Selling a Franchise Company* at 1, 28th Annual Forum on Franchising 1 (2005).

However, this does not prevent the purchaser from requesting that undertakings and construction contracts form part of the closing conditions (and perhaps that work is commenced prior to closing).

B. *Regulatory Compliance*

Franchising, in many jurisdictions, is a specifically regulated business activity. Moreover, within jurisdictions, franchisors may operate under a multilevel regulatory scheme. All this serves to make compliance with laws a complex matter for franchisors.[5] Specific franchise and business opportunity laws can also regulate the sale of franchises, the ongoing conduct of franchisors, and the ending of the franchise relationship. In addition to filing, registration, disclosure, and business opportunity laws, a host of other laws apply to franchise systems. Given its complex web of arrangements that, in some cases, may span the globe, the franchisor seller will normally look to qualify, restrict, and limit the general representation regarding compliance with laws. There are potential minefields for unsuspecting sellers that agree to a broad representation and warranty in this regard. Having said that, conventional wisdom would suggest that allocating risk (as it relates to legal compliance) to the seller makes sense, given that it should have appropriate control over its system. For the purchaser, it is important to ensure that the general (compliance with laws) representation and warranty does not interfere with or compromise (or otherwise create ambiguity with respect to)[6] more specific representations and warranties given in respect of franchise laws. Moreover, the following matters should be addressed by the regulatory and compliance representations and warranties:

- Included is the list of jurisdictions (national and international) in which the franchisor offers franchises for sale, or otherwise conducts its franchise business, including the jurisdictions in which filings or registrations are required.
- The franchisor has complied with all applicable franchise laws, including those relating to filings, registrations, updates/revisions, and disclosure, and relevant business relationship laws in all jurisdictions in which it offers, sells, and operates the franchise system, and the purchaser has been provided with copies of all filings and registrations documentation pertaining to such compliance.
- The franchisor has not received any orders, revocations, default notices, or requisitions of any description from, and there are no administrative

5. Mark Kirsch, Esq., CFE, Scott Pressly, CFE, Patrick Walls, Esq., CFE, *A Seller's Guide to Preparing to Sell the Franchise System* at 23, IFA Legal Symposium (2009), http://www.plavekoch.com/documents/Kirsch_Pressley_Walls_2009_Paper.pdf.

6. Interference, ambiguity, or compromise can occur for example in circumstances where the general representation and warranty is qualified by materiality, but a specific representation and warranty on a similar subject matter is not so qualified.

actions or current proceedings with, any administrative or regulatory agency in any jurisdiction (whether or not related to filings or registrations).

- Included is a list of all franchise disclosure documents (and their respective jurisdictions), together with a representation and warranty that the franchisor has provided to the purchaser true and complete copies of all such franchise disclosure documents used by the franchisor over a defined period.
- In jurisdictions where a franchise disclosure document is required, such disclosure documents have been prepared, maintained, updated, and delivered to franchisees strictly in accordance with the franchise laws of that jurisdiction, including with respect to all requisite filings, registrations, updates/revisions etc.
- The franchise disclosure documents and all other advertising and marketing materials used by the franchisor (current and previous within a defined period) do not contain any untrue statements or misrepresentations, and where earnings claims or financial performance representations have been included, they have been calculated on the basis of correct and accurate information.
- Except for the earnings claims or financial performance representations included in franchise disclosure documents, the franchisor has not authorized its representatives to provide any information or documentation that could be construed as such.

C. *Disputes*

Disputes and court actions have the potential to harm a brand. This is not limited to actions instituted by the franchisee against the franchisor, but also by others in contractual relationships with the franchisor, e.g., suppliers, as well as third parties, e.g., vicarious liability claims. The latter are on the increase as seen in recent joint employer and data breach litigation. Furthermore, disputes and the commencement of litigation may result in copycat actions, a class/group action against the franchisor, or both. A prudent purchaser should therefore take care to conduct searches at all levels of the franchise system with respect to court actions to ensure that all information about any litigation is uncovered. This due diligence requires a number of judgment calls as to the extent of the searches to be conducted across different jurisdictions and different levels within the web of the franchise relationships. It is also advisable to review franchisee files to determine the kinds of issues that may have given rise to disputes but that were either settled with, or abandoned by, franchisees. These considerations should not be limited to existing franchisees, but should extend to former franchisees that recently departed the system that may have claims against the franchisor with respect to the termination, transfer, or otherwise. As discussed in "Franchisee

Satisfaction" in Part I of this article,[7] franchisee associations may also be a valuable source for this kind of information.

Generally, the representations regarding litigation state that all litigation that the franchisor is aware of is listed in a schedule to the purchase agreement. They typically go on to state that the seller is not aware of any other facts that could lead to a court action. The purchaser may request, particularly where the franchisor is also the manufacturer/supplier of certain inputs, that the seller specifically represent that there are no product liability claims, pending or threatened, alleging any defects in the design or manufacture of the products of the seller or any materials used to produce such products. The purchaser may also wish to include specific language stating that there are no pending or threatened actions with respect to the seller's intellectual property, including copyright and patents. Sellers generally look to include knowledge qualifiers for at least some elements of the litigation representation and warranty to limit their liability. A purchaser may look to broaden the litigation representation and warranty to include other entities, such as master franchisees.

D. *Financial and Unit Economics*

In any acquisition, obtaining accurate and correct financial statements concerning the target is critical. The financial statements contain much of the information upon which the purchase price is based.[8] The importance of due diligence with respect to financial information cannot be overstated. In the case of a franchise system, the franchisor derives its revenue from multiple layers of business activity, e.g., the franchisor's direct franchisees, master franchisees and their franchisees, and area developers. Robust unit economics are a strong indicator of the health of a franchise system and are necessary for the ongoing positive financial performance of the franchisor.[9] In light of the above, the purchaser should ensure that the financial information provided is sufficient to permit it to do the following:

- Gain a clear understanding of the quality of the royalty stream (stress testing), including an appreciation of the nature of the franchisee population.
- Scrutinize two key aspects of franchise unit economics: (1) the turnkey development costs, e.g., franchise fees, build out costs, working capital, inventory, and initial marketing; and (2) the annual cash profits that franchisees generate.[10]

7. Marrocco, *supra* note 1, at 121.
8. *See supra* note 6.
9. Kirsch et al., *supra* note 5, at 29.
10. *Id.* at 9.

- Ensure that the financial statements clearly delineate recurring revenue from one-time payments.
- Analyze and form a view as to the likely percentage of upcoming terminations and non-renewals (by either party) of franchise arrangements and model how royalty streams will be affected.
- Take a position on the delinquent franchisees (in consultation with the franchisor seller) to model probabilities of lost revenues.

The representations and warranties regarding financial statements normally state that the seller's financial statements have been prepared in accordance with consistently applied generally accepted accounting principles and present fairly and accurately the revenues, results, assets, and liabilities of the franchise business. Ideally, and to the extent possible, the financial information included in the latter representation and warranty should include all the information that the purchaser relied on in its valuation assessment. Generally, financial statements will be included in a schedule affixed to the purchase agreement. Where the franchisor operates internationally, there may need to be more specificity as to the particular standards to which the financial statements have been prepared. In addition, the purchaser should also assess as part of its due diligence whether the financial statements provided to prospective franchisees (in the franchise disclosure document) were prepared in compliance with franchise laws (other laws and accounting principles) in the relevant jurisdiction(s).

E. *Advertising Fund*

In a franchise system, a franchisor will almost always require that its franchisees contribute to one or more marketing and promotional funds. It is not uncommon for such funds to be a contentious part of the franchisor-franchisee relationship. This is because franchisors typically have broad discretion over how to apply the funds, and franchisees often have a clear idea as to how they believe the funds could be utilized to benefit their territory. As such, the purchaser should make itself aware of any issues related to the advertising fund and its management/administration, and should ensure that the funds have been spent consistently with documented policies that comply with the terms of the franchise agreements. Franchisee files, franchisee association correspondence, and minutes of meetings should be closely reviewed to uncover any disputes or concerns that have been raised previously by franchisees on the management of the advertising fund.

In some transactions, the proposed advertising fund due diligence is not possible because of the scale of the transaction, the lack of manpower of the purchaser, or poor record keeping by the franchisor. In such cases, the representations and warranties become especially important. Generally, a representation and warranty on this topic should state that the franchisor has: (1) kept proper records for all monies spent on advertising and marketing (and provided same to the purchaser); (2) the management and administra-

tion of all funds has been conducted in compliance with all relevant agreements and franchise laws; and (3) there are no actual or threatened claims regarding the management and administration of the funds. In addition, representations and warranties, if pertinent, could be included as to the viability of the advertising fund (i.e., that there are sufficient funds to meet ongoing obligations), the franchisor's ownership of all advertising and marketing materials, and that all arrangements with third parties are in good standing.

III. Canada and Foreign Jurisdictions

When advising clients on international franchise transactions, local counsel are often engaged to advise on the relevant local laws as they relate to franchising as well as other relevant areas of law. Best practices in franchise M&A mandate a similar process. For the purposes of due diligence, engaging with local counsel in a more meaningful way is the recommended (and ultimately the best and most effective) approach rather than having local counsel simply rubber stamp purchase agreements and provide memos on franchise laws in the relevant jurisdiction. Engaging local counsel to undertake the portion of the due diligence that relates to their jurisdiction (e.g., review of franchise agreements for that specific jurisdiction) and assisting with the crafting of certain representations and warranties leads to a more efficient and effective process. The relevant local counsel is best placed, for example, to review the agreements relating to their jurisdiction, especially where franchise laws are enacted.

Canada provides a cogent example of similar yet unique franchise laws that militate in favor of having Canadian counsel participate in due diligence and drafting of the purchase agreement, particularly with respect to representations and warranties. Franchising is provincially regulated in Canada. Currently, only five out of Canada's ten provinces (and three territories)—Alberta, Manitoba, New Brunswick, Ontario, and Prince Edward Island—have franchise legislation in force. British Columbia's recently enacted franchise legislation and more recently finalized franchise regulations will come into force on February 1, 2017. Franchise legislation across the provinces is similar, but there are nuances (e.g., with specific disclosure requirements) that must be borne in mind when conducting due diligence. Moreover, when conducting due diligence on the Canadian franchise arrangements of a U.S. (or international) franchise system, the following recent developments demonstrate how knowledge and experience with Canadian franchise law (and Canadian law in general) can provide valuable insight on the due diligence phase and on strategy post-closing of the transaction.

- Ontario recently enacted legislation[11] to amend its franchise law to permit delivery of a franchise disclosure document by electronic means; previously, such delivery was not permitted. However, practitioners

11. O. Reg. 581/00: General s. 12.

in the field are still developing the practice of disclosure by electronic means in a way that is consistent with other provisions of the legislation. For example, s. 5(3) of the *Arthur Wishart Act* (Franchise Disclosure), 2000, requires a disclosure document to be delivered as "one document at one time." This raises questions regarding the new electronic means of disclosure: what happens if one document is too large to be transmitted as one email file? Purchasers require assistance in assessing whether franchise disclosure documents issued by electronic means comply with the legislation.

- The approach to drafting non-competition covenants has shifted in light of the recent case of *MEDIchair LP v DME Medequip Inc.*[12] where the Ontario Court of Appeal refused to enforce a non-competition covenant on the grounds that the franchisor had no intention of continuing to operate in the protected geographic area. The court concluded that there was no "legitimate interest" to protect in the circumstances. Purchasers may want to undertake a specific assessment of the communications between franchisors and their Canadian franchisees to determine whether the franchisors' rights under non-competition covenants may have been compromised on the basis described above.
- The Canadian approach to system change has been refined as a result of the *Tim Hortons*[13] case, which addressed the franchisor's right to modify its system. The Ontario Superior Court of Justice found that Tim Hortons had complied with its contractual obligations under the franchise agreement; had acted in good faith by making decisions honestly and reasonably for legitimate business purposes; and had appropriately conducted a consultation process with its franchisees, taking their legitimate interests into consideration. If recent system changes have been implemented in a target system with Canadian franchise units, purchasers will want to assess the manner in which such changes were introduced in light of the Canadian jurisprudence.
- Complex and controversial are the lessons learned from the *Dunkin' Donuts*[14] case regarding the obligations of a franchisor to its franchisees, and the brand as a whole, and their application to provinces outside of Québec.[15] If a target international system includes Canadian franchise

12. MEDIchair LP v DME Medequip Inc., 2015 ONSC 3718.
13. Fairview Donut Inc. v The TDL Group Corp., 2012 ONSC 1252.
14. Bertico Inc. c. Dunkin' Brands Canada Ltd., 2012 QCCS 2809.
15. The court found that by not taking adequate steps to support and protect the Dunkin' Donuts brand from the influx of Tim Hortons in Québec, the franchisor had fundamentally breached the terms of its franchise arrangement, including implied covenants of good faith. The court said that brand protection is "an ongoing, continuing and successive obligation" of the franchisor. It is important to note, however, that this is a Québec decision and will have varying influences on other Canadian provinces. *See* Andraya Frith, Éric Préfontaine & Gillian Scott, La Belle Province: *A Practical Business Guide to Key Legal Issues When Franchising in Québec*, 36:2 FRANCHISE L.J. 303 (2016).

units, it would be worthwhile assessing the relationship between the franchisor and the Canadian franchises and whether there are any vulnerabilities when it comes to the franchisor's approach to protecting and supporting the franchise brand in Canada.

- Labor laws and joint employer issues are distinct and in some cases vastly different from the United States. Unlike the United States (where the issue is being developed by the courts), Ontario is currently undergoing a review of its legislation (*Labour Relations Act, 1995* and the *Employment Standards Act, 2000*), and submissions have been made on the approach to joint employer status.[16] As the review of the legislation unfolds and beyond, purchasers will require assistance—and suggestions on how to improve the situation as required—in considering their position vis-à-vis how the target system's current franchise arrangements with Canadian franchisees stand in light of Canadian joint employer standards.
- A franchisor's involvement in the resale of franchise units has been scrutinized and best practices modified as a result of a number of recent cases[17] where courts have ruled that franchisors incorrectly relied on the exemption from having to provide a disclosure document (the Resale Exemption) under Ontario law.[18] When conducting due diligence on franchise resales (where franchise units have been sold by one franchisee to another) in Canada over the preceding two years (the maximum statutory rescission period), purchasers of a system will want to ensure that the franchisor either disclosed the incoming franchisee or that it appropriately relied on the Resale Exemption.

In addition to the ever-increasing changes to legislation and common law, local counsel can address other jurisdiction specific matters, such as intellectual property protection and registration, antitrust/competition laws, real estate and environmental law, privacy laws, foreign investment restrictions, and Québec's civil law system—to name a few. Moreover, to the extent that it is relevant to the context of the transaction (e.g., a U.S. purchaser looking to acquire a Canadian based franchise system), local counsel can assist in negotiating more favorable terms in the purchase agreement based on

16. Proposed amendments to these laws include a proposal to deem a franchisor a joint employer of its franchisees' employees for certain purposes.

17. Brister v 2145128 Ontario Inc., 2014 ONSC 6714; 2147191 Ontario Inc. v Springdale Pizza Depot Ltd., 2015 ONCA 116; 2256306 Ontario Inc. v Daikin News Systems Inc., 2015 ONSC 566.

18. Under ss. 5(7)(a)(iv) and 5.8(a) and (b) of the *Wishart Act*, franchisors are exempt from providing disclosure where "the grant of the franchise is not effected by or through the franchisor." Ontario courts have consistently taken a narrow view of this exception to statutory disclosure obligations. A franchisor will generally be exempt where it is involved only in (1) exercising its right to consent to the transaction and (2) accepting a transfer fee. In cases where the franchisor has taken more than a passive role (e.g., by changing the term of the arrangement) in the assignment process, it is required to abide by the *Wishart Act*'s disclosure obligations.

their knowledge of what is considered "market" in their jurisdiction. For example, survival periods for representations and warranties tend to be longer in Canada, and Canadian sellers are more likely to agree on a full disclosure representation than sellers in the United States.

In summary, local counsel can assist by identifying the relevant issues in their jurisdiction from the outset of a transaction, comprehensively planning and conducting jurisdiction specific due diligence, and making comments on the purchase agreement in order to manage and allocate risk more effectively.

IV. Conclusion

The sophistication of franchise M&A has evolved significantly over the past decade, and with it the number of franchise attorneys with the corporate M&A proficiency required to competently advise on such transactions. For corporate M&A attorneys, the need to understand the nature of the franchise business model and the unique considerations associated with the complex web of relationships that comprise a franchise system are critical. Knowledge, skill, and experience with respect to both corporate M&A transactions and franchise law are a formidable combination when it comes to advising on franchise M&A transactions, which have developed into a distinct area of law in their own right. From this, it is hoped that more articles, whether academic, analytical, or practical, will be written to increase the body of literature around franchise M&A. Both Part I and Part II of this article provide insight on a more sophisticated approach to franchise M&A by exploring best practices in drafting representations and warranties and focusing on certain key representations and warranties in a franchise M&A purchase agreement. The best practice principles addressed in this article, along with the underlying rationale, tools of analysis, and informal checklists, will assist attorneys in navigating franchise M&A transactions and successfully advising their clients through the entire process.