

**RECENT TRENDS IN FRANCHISE RELATIONSHIP  
LAWS**

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## 1. Introduction<sup>123</sup>

Beginning in the 1950s, with franchisors such as McDonald's, Midas Muffler, and Holiday Inn, the franchise business model has become a popular growth vehicle in both North America and worldwide. That said, the coming of age of business format franchising in the United States during the mid-20th century brought with it abuses by some opportunistic franchisors seeking to line their pockets at the expense of their franchisees. During the late 1950s and throughout the 1960s aggrieved franchisees sought to restrain this opportunistic behaviour by bringing actions for redress based on various theories of contract, tort, unjust enrichment, and fiduciary law, and on statutory anti-trust law and securities law.

The franchisees and the regulators, however, found the results largely unsatisfactory, leading to intervention by certain of the states in the U.S., the U.S. Federal Trade Commission, and the Province of Alberta in Canada in the form of franchise disclosure and registration legislation and regulations in the early 1970s. This initial attempt at franchise regulation was directed at the franchise granting process, and attempted to level the information playing field. Pre-contractual disclosure regulations require franchisors to provide prospective franchisees with certain information about the franchisor, its affiliates, existing and former franchisees, the franchise business, the franchise contracts, the money, and other matters to enable the prospective franchisee to make an informed decision about investing in the franchise. Today, this form of regulation continues to dominate the global franchise regulatory landscape. However, over the years some jurisdictions have also enacted relationship legislation in addition or as an alternative to disclosure and registration laws.

The rise of relationship laws recognized that while disclosure laws provided protection to the franchisee prior to entering into a franchise agreement, they offered no remedy against opportunistic conduct that extended beyond contract formation. Franchise relationship legislation, then, was directed at the continuing business relationship of the parties after the franchise agreement was signed. It was intended to restrict franchisors' discretion in certain areas of contract performance which the regulators thought were of critical importance to franchisees; such as, the duty of good faith and fair dealing, franchise transfers and renewals, termination, procurement, and encroachment on franchisee territories. Today, with a handful of exceptions which are "disclosure only" regimes, the majority of franchise laws and regulations around the world contain both pre-contractual disclosure and on-going relationship elements; a few countries have opted for the "relationship only" approach.

What follows is an overview of franchise relationship laws around the world and the aspects of the franchise relationship these laws typically address. While not the focus, this paper will also examine the impact of self-regulation, industry specific legislation, and Australia's Commissioner Model on the franchise relationship. In the conclusion, the analysis will rely on the unique characteristics of the franchise model in an effort to provide the reader with conclusions and lessons learned.

## 2. Franchise Relationship Laws

As noted above, franchise relationship laws govern explicitly the franchise relationship after the franchise agreement has been signed, providing extra-contractual protection to franchisees. They seek to level the playing field between franchisors and franchisees, who are of-

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<sup>1</sup> This paper was presented by the International Franchising Committee at the IBA Annual Conference in Dubai on 30 October 2011 to 4 November 2011.

<sup>2</sup> I wish to express my sincere appreciation to Christine A. Jackson, an associate of Sotos LLP, for her invaluable assistance and contribution in drafting this paper.

<sup>3</sup> I further wish to extend great thanks to Professor Karsten Metzloff (Noerr LLP), Anna Tsirat (Jurvneshservice), and Tao Xu (DLA Piper), for their exceptional editorial contribution and assistance with this paper.

ten presented with a standard form franchise agreement on a take-it-or-leave-it basis. Relationship laws provide minimum relationship standards, override certain provisions contained in franchise agreements, or require an overriding duty of good faith.

Why are relationship laws important? The success of every business format franchise network depends on each franchised unit at all time presenting an image to the public of being but one of a large chain of identical units, all offering the same quality goods or services and customer experience. To maintain this vital image the franchise contracts must necessarily include a great many significant controls on the franchisee's method of operation, and as a corollary most franchisors will also offer significant assistance in that method of operation. As mentioned above, a franchisor is thus highly motivated to use standard-form contracts, so that the same terms will govern all of its franchise relationships of the same type, and for the same reason these contracts are usually presented to prospective franchisees on a take-it-or-leave-it basis. Thus franchise agreements are both relational contracts that confer discretion on a party, that is, the franchisor, to deal appropriately with certain unpredictable future events, and contracts of adhesion that are drafted for the franchisor's benefit. While these features are necessitated by the business reality and the franchisor's need to control its brand image and system uniformity, as a practical result, these agreements require a fair amount of trust between parties and are rarely freely negotiated, conferring little, if any, discretion on the franchisee. By their very nature, franchise agreements are characterized by a disparity in bargaining power that could give a self-seeking franchisor opportunities to abuse its discretionary power to the detriment of the franchisee. Franchise relationship laws, then, are designed to restrict the power franchisors exude over franchisees. Generally, the areas at which relationship laws are aimed to address include: unjust termination; no renewal rights; no right to assign; restricting free association among franchisees; discriminating between franchisees; and bad faith.

It should be noted that while the franchise relationship laws in North America predominantly deal with restrictions on franchisors and protection of franchisees, franchise relationship laws in other parts of the world often impose obligations on franchisees as well. For example, Article 18 of China's *Regulation on the Administration of Commercial Franchises* provides that the franchisee must not transfer the franchise without the franchisor's approval, and must not disclose or allow others to use the franchisor's trade secrets.<sup>4</sup> Malaysia's *Franchise Act 1998* stipulates that the franchisee and its employees must not carry on any business similar to the franchised business both during the franchise agreement term and for two years after expiration or termination of the franchise agreement.<sup>5</sup> These provisions may be of limited value to international franchisors, as their franchise agreements typically include such restrictions on the part of the franchisees, but they are reflective of the regulators' acceptance that franchising is a distinct method of doing business, which, as discussed above, makes certain restrictions on the part of franchisees appropriate and necessary.

### **3. Other Laws Affecting the Franchise Relationship**

In addition to these franchise relationship laws, a number of countries have enacted commercial agency or distributorship laws that are not specifically targeted at franchise relationships but that under a variety of circumstances may apply to franchises. While a discussion of these laws is important for understanding the complete picture of relationship regulation, such a discussion is regrettably outside the scope of this paper. Interested readers should refer to *How Commercial Agency Laws Impact Franchise Relationships*.<sup>6</sup>

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<sup>4</sup> *Regulation on the Administration of Commercial Franchises* (No. 485 of 2007, China).

<sup>5</sup> *Franchise Act 1998*, Act 590.

<sup>6</sup> Andrew Loewinger, IBA Annual Conference – International Franchising Committee (October 30-November 4, 2011) Dubai.

Outside of specific franchise laws and agency/distributorship laws, there are also a number of other bodies of laws that will affect the franchise relationship, including, for example, general contract laws<sup>7</sup>, competition laws<sup>8</sup>, intellectual property laws (particularly those dealing with trademark license and technology transfer)<sup>9</sup>, and foreign exchange control regulations<sup>10</sup>. In some countries, cases decided by courts have also impacted the franchise relationship.<sup>11</sup> These are also outside the scope of this paper and will not be addressed here.

#### 4. Impact on International Franchise Transactions

The franchise relationship laws are primarily designed and adopted to apply to domestic franchise agreements, where both the franchisor and franchisee are within the country, but they also affect “cross-border” franchise agreements, where a foreign franchisor enters into an agreement with a domestic franchisee, in a number of important ways.

More often than not, cross-border franchise agreements are governed by the law of the franchisor’s jurisdiction. Sometimes, the law of a “neutral” jurisdiction (England and Wales, and State of New York being the most common choices) is chosen. However, some franchise relationship laws require that the law of the franchisee’s jurisdiction will apply. In the case of Indonesia, the entire franchise agreement must be governed by Indonesian law.<sup>12</sup> In the case of the U.S. states with franchise laws, these laws will apply to matters they regulate regardless of the parties’ choice of law. Franchisors that enter into cross-border franchise agreements with franchisees from these jurisdictions will need to adjust their franchise agreements accordingly.

Even if a jurisdiction’s franchise relationship law does not mandate a specific governing law, it would be prudent for international franchisors to assume that such law would apply to their cross-border franchise agreements regardless of the choice of law provision. Therefore, international franchisors should proactively adjust their franchise agreements to try to comply with the franchisee country’s franchise relationship law requirements. Otherwise, the franchisor might risk the entire franchise agreement, or entire provision of significant importance, be-

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<sup>7</sup> For instance, China’s Civil Code and Contract Law provide that commercial transactions (which would include franchise transactions) must be conducted in good faith, see PRC Civil Code, Article 4 and PRC Contract Law, Article 6. In addition, the right of the franchisor and the franchisee to assign the franchise agreement is regulated under China’s Contract Law, in addition to its franchise regulation, see PRC Contract Law, Chapter 5.

<sup>8</sup> EU’s Vertical Restraints Block Exemption Regulation is probably the most prominent example, and affects all franchised businesses operating in the EU (and EU candidate countries like Turkey). Venezuela’s competition law also affects franchise agreements, although, given the country’s recent imposition of foreign exchange regulations that made it almost impossible to make outbound royalty payments, competition law requirements are probably the least of an international franchisor’s concerns over there. Lastly, it should be noted that some franchise laws and regulations are issued under the competition law and/or are administered by the competition authority, including, for example, Japan, South Korea, and Taiwan.

<sup>9</sup> Registered user filing is a common feature of trade-mark laws around the world. Occasionally, such registration requirement would require modification to the franchise agreements. The application of technology transfer regulations to franchise agreements has been much more problematic in certain countries (for example, the Philippines), as these technology transfer regulations tend to afford generous protection to licensees (for example, no indemnity of the licensor by the licensee), and impose requirements that are difficult to implement in a franchising context (for example, the requirement that the licensee not be restricted from using the licensed technology after expiration/termination of the license agreement).

<sup>10</sup> To the extent a country regulates the flow of money, it mostly focuses on the authenticity of the transaction. A few countries, however, have tried to regulate the amount of fees paid overseas. While India’s restriction on royalty fee amount and the subsequent lift of such restriction have garnered a lot of attention, countries like Nigeria continue to impose caps on royalty fees paid overseas that have effectively stopped most foreign franchisors from entering into the country and competing with indigenious franchisors, who do not face such restrictions.

<sup>11</sup> For example, as Andrew Loewinger and John Pratt reported in 2008, in *Fleet Mobile Tyres v. Stone & Ashwell*, (2006) 103 (35) L.S.G. 32, (2006) 150 S.J.L.B. 1150, 2006 WL 2524798, the English Court of Appeal “introduced the concept of ‘derogation from grant’ which is potentially similar to introducing an obligation of ‘good faith’ into franchise agreements. See *Recent Changes and Trends in International Franchise Laws*, Andrew Loewinger and John Pratt, American Bar Association 31st Forum Annual Forum on Franchising (October 15-17, 2008).

<sup>12</sup> Regulation of the Minister of Trade No. 31/M-DAG/PER/8/2008 art. 5(1).

ing found unenforceable due to some aspect of the franchise agreement not being compliant with certain relationship law requirements. Such revisions, however, should not be “blindly” added into the franchise agreement. A better approach would be to add language to override certain provisions in the franchise agreement, but clarify that such overriding is only applicable to the extent required by applicable law. Otherwise, the franchisor might find itself being bound by contractual requirements that are no longer required by law due to legislative changes. Recent changes to South Korea’s *Fair Franchise Transactions Act* serve as an excellent example in this regard.<sup>13</sup> The prior law’s onerous requirements with regard to termination procedure were deleted, but franchisors who directly built the termination procedural requirements into their franchise agreements would not be able to enjoy the benefit of such revisions.

## 5. Countries in which Franchise Relationship Laws Exist

Franchise relationship regulation takes on numerous forms varying from jurisdiction to jurisdiction.<sup>14</sup> Countries such as the United States of America<sup>15</sup>, Canada<sup>16</sup>, Australia, China, South Africa, Malaysia, Russia, Ukraine, Romania, Lithuania, Belarus, Moldova, Macau, South Korea, and Vietnam all offer comprehensive regulatory regimes. These countries have enacted either franchise-specific or consumer protection legislation which embody explicit laws governing the franchise relationship. Other countries, such as, Mexico, France, Japan, Italy, Albania, Tunisia, Estonia, Georgia, Indonesia, Venezuela, Moldova, Saudi Arabia, and the Province of Quebec in Canada can be classified as minimalist regulatory regimes.<sup>17</sup> For the most part, the laws and principles applicable to the ongoing franchise relationship in these countries and the Province of Quebec arise out of their respective Civil Codes.<sup>18</sup>

## 6. Recent Trends of Franchise Relationship Laws

The last decade has witnessed an explosion of franchise laws and regulations. In the Asia-Pacific region alone,<sup>19</sup> with the exception of Malaysia (1998), Kyrgyzstan (1998), and Macau (1999), all the franchise laws and regulations were adopted or significantly amended after 2000, including countries and regions such as China (2007), Japan (2002), South Korea (2008), Taiwan (2003), Vietnam (2008), Australia (2010), Indonesia (2005), and Kazakhstan (2002). This growth of franchise laws and regulations is also seen in Europe (Belgium, Italy, Romania, Spain, Sweden), the Americas (several Canadian provinces,<sup>20</sup> Mexico, and the U.S. FTC Franchise Rule), and elsewhere (for example, South Africa). With a few notable exceptions (the U.S. FTC Franchise Rule, Taiwan, Belgium, Spain and Sweden), these new franchise

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<sup>13</sup> *Fair Franchise Transactions Act*, amended in part on 2007, Law No. 8630.

<sup>14</sup> Schedule A to this paper provides a quick reference chart summarizing the relationship issues addressed by each jurisdiction.

<sup>15</sup> In the United States, 21 States, the District of Columbia, Puerto Rico, and the US Virgin Islands have enacted relationship laws governing the ongoing relationship between franchisor and franchisee. There are no federal franchise relationship laws of general application.

<sup>16</sup> Like the United States, Canada has no federal legislation governing the franchisor-franchisee relationship. Only 5 of the Provinces in Canada have enacted franchise-specific legislation that, among other things, governs the franchise relationship. They are, Alberta, Ontario, Prince Edward Island, New Brunswick, and Manitoba. Note, however, the Manitoba legislation is not yet in force and is to come into force on a date to be fixed by proclamation.

<sup>17</sup> Note, both Kyrgyzstan and Mongolia have franchise legislation containing relationship laws. Unfortunately, an English translation of these particular pieces of legislation could not be obtained for the purposes of writing this paper.

<sup>18</sup> Schedule B to this paper provides a comprehensive map of the countries with relationship laws.

<sup>19</sup> The Asia-Pacific region is arguably the most active region in terms of adopting new franchise regulations and significant amendments to existing laws. In addition, it seems that it is the only region outside of the U.S. that has “franchise offering registration” requirements (e.g., China, South Korea, Vietnam, and Malaysia). Spain at one point had a registration requirement but this was deleted as part of the 2006 amendments.

<sup>20</sup> *Franchises Act*, R.S.A. 2000, c. F-23, *Arthur Wishart Act (Franchise Disclosure) 2000*, S.O. 2000, c. 3, *Franchises Act*, R.S.P.E.I. 1998, c. F-14.1, *Franchises Act*, S.N.B. 2007, c. F-23.5, *Franchises Act*, S.M. 2010, c. 13.

laws and regulations have opted to both require pre-contractual disclosure and regulate the franchise relationship.

Why have so many jurisdictions adopted relationship laws as of late? With the franchise business model penetrating more and more business communities worldwide, perhaps governments have recognized that the successful regulation of franchising must be supported by two pillars – information disclosure before the execution of the franchise agreement, and certain minimum requirements as to the franchisor’s and the franchisee’s conduct in carrying out the franchise agreement. Franchise agreements, remember, are both relational contracts and contracts of adhesion, and as such, necessarily feature a disparity in the exercise of discretion and a degree of incompleteness. Broadly stated, relationship laws aim to ensure the franchise agreement is administered, enforced, and carried out in good faith, although what constitutes “good faith” is, regrettably, not always clear. More specifically, on the franchisor side, relationship laws enhance ongoing protection to franchisors with respect to quality control and confidentiality. For the franchisees, relationship laws offer them additional protection from practices such as unjust termination or refusal to comply with the renewal provisions.

On the other hand, it is notable that other than provisions of general application contained in Civil Codes no major country has adopted a “relationship only” franchise law in quite a while. Russia, being one of the few “relationship only” countries, recently amended its franchise law, and interestingly the amendments appear to be drafted in the franchisor’s benefit.

## **7. Relationship Laws and the Aspects of the Relationship they Address**

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

Simply put, the duty of good faith and fair dealing is a positive obligation on the franchisor and franchisee to deal with each other honestly, fairly, and in good faith, so as to not destroy the right of the other to receive the benefits of the agreement. It requires the franchisor to act with due regard for the reasonable interests of the franchisee, and exercise its discretion honestly, fairly, and reasonably. Put another way, the duty of good faith requires that the franchisor, in exercising its contractual discretion, must do so “reasonably and with proper motive, and may not do so arbitrarily, capriciously, or in a manner inconsistent with the reasonable expectations of the parties.”<sup>21</sup> Where a party to a franchise agreement breaches the duty, the other party has a right of action for damages. Depending on the jurisdiction, the right will apply to the performance and enforcement of the agreement and may in some instances extend to the exercise of any right under the agreement.<sup>22</sup> The duty has made its way into various pieces of franchise legislation worldwide, and in civil law jurisdictions it applies to the franchise relationship by virtue of the fact that a franchise agreement is a type of commercial contract governed by the country’s Civil Code.

In the Canadian Provinces with franchise legislation, with the exception of the Province of Alberta, the duty of fair dealing includes not only the duty to act in good faith but also that the duty be exercised in accordance with reasonable commercial standards. Phrasing the duty in this way has broadened the application of good faith to franchise agreements and includes any ancillary agreement relating to the franchise. In the remaining Canadian Provinces, the duty is applied to the franchise relationship as an implied contractual covenant. In the United States, states like Arkansas, Hawaii, Iowa, Minnesota, and Washington all require a duty of good faith. Other states view the duty as an implied covenant, which only applies when the contractual language is not clear on any particular issue. In Estonia, the *Law of Obligations*

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<sup>21</sup> *Carvel Corporation v. Baker*, 79 F. Supp. 2d 53 (D. Conn 1997) at para. 69.

<sup>22</sup> Compare section 3 of the *Arthur Wishart Act (Franchise Disclosure) 2000*, S.O. 2000, c. 3 to section 3 of both the *Franchises Act*, R.S.P.E.I. 1998, c. F-14.1 and the *Franchises Act*, S.N.B. 2007, c. F-23.5.

*Act*<sup>23</sup> provides for both principles of good faith and reasonableness. In determining whether a contractual provision is reasonable or if it is a breach of the principle of good faith, the Estonian practice is to consider the nature of the contractual obligation, the purpose of the agreement, the usages and practices in the relevant field of activity, and any other circumstances.

The duty of good faith in China can be found in both the *People's Republic of China Civil Code*<sup>24</sup> and the *Regulation on the Administration of Commercial Franchises*<sup>25</sup>. Article 4 of the latter provides that the principles of free will, fairness, honesty, and good faith shall be followed in franchise activities. Malaysia's *Franchise Act 1998*<sup>26</sup> similarly imposes a positive obligation on both franchisor and franchisee to act in an honest and lawful manner endeavouring to pursue the best franchise business practice of the time and place. In considering whether parties have acted in good faith, the Malaysian practice will look to whether there were unreasonable overvaluation of fees and prices, unnecessary and unreasonable conduct in relation to risks, and conduct not reasonably necessary for the protection of legitimate business interests. In South Africa, the duty is embodied in the recently enacted *Consumer Protection Act*.<sup>27</sup> Under the legislation, franchisees are explicitly included in the definition of consumers and are given a variety of rights akin to acting in good faith; for example, the right to equality, fair and responsible marketing, honest dealing, and fair agreements. The South African legislation goes even further to expressly prohibit unfair, unreasonable, or unjust contract terms. In South Korea, the *Fair Franchise Transactions Act* imposes a principle of good faith on both the franchisor and franchisee in the performance of their respective duties. The Macau *Commercial Code* recognizes a contractual duty of good faith and fair dealing and both Japan and Taiwan imply a duty of good faith into most franchise agreements. Lastly, in Australia recommendations have been made to introduce legislation requiring a duty of good faith in franchising. These recommendations, however, have yet to be adopted and at present the duty is imposed as a principle of common law.

## 7.2 The Duty to Provide Support

The duty to provide support takes different forms depending on the franchise relationship. In most jurisdictions it is governed solely by the franchise agreement and generally includes things such as providing initial instructions and training to the franchisee, continuing on-site operational guidance, technical support, and operations and other manuals. Countries, for example, like South Korea, China, Australia, Estonia, Lithuania, Russia, Ukraine, Belarus, Moldova, and Malaysia have all chosen to include this duty in their respective franchise legislation. Article 5 of South Korea's *Fair Franchise Transactions Act* requires a franchisor to provide, among other things, education and training, continuing advice, and support. In China, Article 14 of the *Regulation on the Administration of Commercial Franchises* provides that a franchisor shall provide its franchisees with an operations brochure and continued business guidance, technical support, and training. Regulation 15 of Australia's *Franchising Code of Conduct*<sup>28</sup>, entitled Franchisor's Obligations, requires the franchisor to provide training both prior and during the operation of the franchised business. Similarly, Chapter 19 of Estonia's *Law of Obligations Act* places an obligation on the franchisor to provide the franchisee with instructions and permanent assistance. In Lithuania, franchisors must provide continuous technical and consulting assistance to the user and assist in training his or her employees. Similar wording is found in Chapter 54 of Russia's *Civil Code*.<sup>29</sup> With respect to Ukraine and Belarus,

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<sup>23</sup> *Law of Obligations Act*.

<sup>24</sup> *People's Republic of China Civil Code*.

<sup>25</sup> *Regulation on the Administration of Commercial Franchises* (No. 485 of 2007, China).

<sup>26</sup> *Franchise Act 1998*, Act 590.

<sup>27</sup> *Consumer Protection Act*, (Act No. 68 of 2008).

<sup>28</sup> *Franchising Code of Conduct*.

<sup>29</sup> *Russian Civil Code*, Chapter 54 (Articles 1027-1040).

the duty is found in chapters 76<sup>30</sup> and 53<sup>31</sup> of their respective Civil Codes. In Moldova, the duty is found in both chapter XXI of the *Civil Code*<sup>32</sup> and article 9 of *The Law of the Republic of Moldova on Franchising* and requires the franchisor to support the franchisee through training and information.<sup>33</sup> Lastly, in Malaysia, this duty includes providing the franchisee with materials and services, training, marketing, and business or technical assistance.

### **7.3 The Cooling-off Period**

The cooling-off period allows the franchisee to terminate the franchise agreement within a specified period after entering the agreement, or prior to the payment of any non-refundable money. Some jurisdictions take the view that a cooling-off period is a necessary protection that gives a franchisee the chance to “back out” of an executed franchise agreement. In practice, however, it is not clear how much protection the cooling-off period actually provides the franchisees, because these cooling-off periods, due to their nature, will necessarily be short in duration. Australia, China, Malaysia, Mexico, South Africa, Russia, Belarus, and Ukraine all require some sort of cooling-off period after the execution of the franchise agreement during which the franchisee can withdraw from the relationship. These periods range from a thirty day cooling-off period in Mexico to ten business days in South Africa, seven business days in Malaysia, and seven days in Australia. In Russia, Belarus, and Ukraine the cooling-off period is given to both the franchisor and franchisee. China does not specify the length of the cooling-off period; in practice, franchisors there have offered anywhere from one day or several weeks.

### **7.4 Minimum Term**

Only three countries and one U.S. state impose a minimum term for the franchise agreement. A minimum term ensures that the franchisee has a chance to recoup its initial investment into the franchised business. In Malaysia, the franchise agreement must be for a minimum period of five years. In Italy the term is three years. The Indonesian legislation requires a minimum term of 10 years for Master Franchise Agreements. Lastly, in both China and the State of Connecticut the term stipulated in the franchise contract shall not be less than three years. Note, however, in China the franchisee can agree to a lesser period.

### **7.5 Restrictions on Termination**

The circumstances in which a franchisor may terminate a franchise agreement are generally governed by the franchise agreement. That said, some jurisdictions have enacted specific relationship laws governing the requirements for termination. For example, in Australia, Malaysia, Vietnam, and fifteen of the U.S. states termination is permissible where: (1) the franchisor has good cause as a basis for termination, i.e., where the franchisee has failed to substantially comply with the franchise agreement; or (2) the situation falls within certain circumstances as enumerated in the legislation, i.e., bankruptcy, voluntary abandonment, insolvency, fraud, criminal conviction. With respect to the former, the franchisor must then comply with certain procedural requirements, such as providing written notice, reasons for termination, and an opportunity to cure the default. Compare this to jurisdictions like Albania, Italy, and France where termination is allowed, with notice, where the franchisee’s breach places the franchise activity at serious risk. Similarly, in China, Japan, and Mexico a fixed term agreement can be terminated where the purpose of the contract cannot be realised due to such things as force ma-

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<sup>30</sup> *Civil Code of Ukraine* of 16.01.2003 No. 435-IV.

<sup>31</sup> *Belorussian Civil Code*, Chapter 53 (Articles 910 - 910-11).

<sup>32</sup> *Moldova Civil Code*, Chapter XXI (Articles 1171-1178).

<sup>33</sup> *Moldova Law on Franchising*, No. 1335 dated 1 January 1997, as amended.

jeure or continuous default by the franchisee. In Russia and Ukraine, termination is allowed in the case of insolvency or where a franchisor loses its trade-mark rights. Lastly, with respect to Canada, the circumstances under which a franchisor may terminate are generally governed by the terms of the franchise agreement with the duty of good faith and fair dealing acting as a backdrop.

It is also worth noting that in some jurisdictions upon termination the franchisor is required to do such things as repurchase inventories, marketing materials, fixtures, and compensate for loss of goodwill. For example, under the *Wisconsin Fair Dealership Law*<sup>34</sup> a franchisor shall repurchase all inventories sold by the franchisor to the franchisee for resale under the franchise agreement at the fair wholesale market value. Hawaii's *Franchise Investment Act*<sup>35</sup> offers similar buy-back protection with the added requirement that the franchisor compensate the franchisee for any loss of goodwill. Under the *California Franchise Relations Act*,<sup>36</sup> where a franchisor terminates a franchise other than in accordance with the *Act*, the franchisor shall offer to repurchase the franchisee's resalable current inventory at the lower of the fair wholesale market value or the price paid by the franchisee. Similar statutory protections of the franchisee's investment exist in Connecticut, Iowa, Michigan, Washington, and Minnesota. This sort of buy-back protection is also found in the industry-specific legislation of a number of U.S. states and the Provinces of Alberta, Ontario, and Saskatchewan as discussed more fully below.

Of a similar vein, some jurisdictions have also prescribed the right of a franchisee to rescind the franchise agreement where the franchisor has failed to comply with disclosure laws. For example, in the Canadian provinces with franchise legislation where a disclosure document or statement of material change is delivered late, not at all, or fails to comply with the legislation the franchisee may rescind the franchise agreement without penalty by giving notice of cancellation to the franchisor. In Ontario, Prince Edward Island, and New Brunswick where rescission takes place the franchisor must refund to the franchisee any money received from or on behalf of the franchisee, repurchase inventory, supplies, and equipment, and compensate the franchisee for any losses incurred in setting up the franchise. Alberta's franchise legislation offers similar protection to the franchisee, but does not require the franchisor to repurchase inventories. In the United States, where a franchisor fails to comply with disclosure requirements under the FTC's Franchise Rule, the FTC impose civil penalties, injunctive relieves, or cease-and-desist orders; to seek rescission, however, the FTC must commence a civil action against the franchisor. At the state level, some jurisdictions offer rescission rights if the franchisor fails to comply with the disclosure requirements. Rescission rights also exist in Belgium, Brazil, China, Italy, and Vietnam.

## **7.6 Restrictions on Arbitrarily Refusing Renewal**

Some jurisdictions have included a right to renew in their franchise legislation. Absent such legislation, and where no renewal provision is explicitly included in the franchise agreement, the franchisee's rights would expire at the end of the agreed term with little or no compensation to the franchisee who developed the business at the location. Conversely, the franchisor could appropriate the location and goodwill through the award of another franchise or operation of a corporate site. Despite this inequity, the majority of jurisdictions have left renewal to the discretion of the parties. This is due, in part, to the ongoing struggle between, on the one hand, proponents of freedom of contract who view franchise agreements as commercial contracts, and on the other hand, advocates of franchisee protection who view franchise agreements as contracts of adhesion. The reality, however, is that franchise agreements are rarely

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<sup>34</sup> *Wisconsin Fair Dealership Law*, Wis. Stat. ch. 135 *et seq.*

<sup>35</sup> *Franchise Investment Act*, Haw Rev. Stat. §§ 482E-6 *et seq.*

<sup>36</sup> *California Franchise Relations Act*, Cal. Bus. & Prof. Code §§ 20000 *et seq.*

freely negotiated and therefore some jurisdictions have found the need for statutory intervention to protect franchisees from renewal provisions drafted in the franchisor's favour.

In the United States, for example, Delaware, Hawaii, Iowa, New Jersey, Rhode Island, and Wisconsin have relationship laws requiring good cause for non-renewal. In Mississippi, Washington, and Missouri the franchisor must provide the franchisee with notice ranging from 180 days to one year. Illinois, Michigan, and Washington have what are called forced renewal rights requiring a franchisor to renew the franchise agreement or repurchase the franchise. For example, in Illinois a franchisor must renew a franchise agreement or repurchase the franchise where a non-compete covenant exists. Malaysia takes a similar approach requiring a franchisor to compensate its franchisee by repurchase or some other means where renewal is refused. Both the Russian and Lithuanian approach to renewal is also somewhat interesting. For instance, in both these countries there is an automatic right of renewal if the franchisee has not been in breach of the franchise agreement and the renewal takes place on the same terms as the original agreement. The franchisor, however, can choose not to renew provided it abstains from opening a franchise in the same territory in the next three years, or, where it wishes to open a franchise in the same territory, it first offers that option to the original franchisee on the same terms as the original agreement. In Canada, while there are no explicit renewal laws, under the duty of good faith and fair dealing, if the franchisor-franchisee have a history of renewal it may prevent the franchisor from refusing a subsequent renewal.

### **7.7 Restrictions on Transfer and Assignment**

Relationship laws dealing with the right to transfer prevent a franchisor from prohibiting a franchisee from transferring his or her interest in the franchise. In the absence of legislation, transfer and assignment rights are governed by the terms of the franchise agreement and the law of contract. The abstention approach is favoured by proponents of the freedom of contract camp who believe a franchisor should be free to restrict a franchisee's ability to transfer its rights and obligations on the rationale that a franchisor's grant of rights to a franchisee is based, in part, on the personal characteristics of a franchisee. On the other side of the argument are supporters of franchisee protection who consider relationship laws to be a sort of counterweight to franchisor power and propensity to abuse rights. What has resulted is legislation which endeavours to strike a balance, protecting vulnerable franchisees while upholding freedom of contract and the franchisor's right to approve a new owner.

In the United States, for example, nine states, namely, Arkansas, California, Hawaii, Indiana, Iowa, Michigan, Minnesota, Nebraska, and New Jersey have enacted relationship legislation limiting the franchisor's discretion to refuse to consent to a transfer. Arguably, the most restrictive of the bunch are the Hawaiian and Michigan statutes which deem it unfair or a deceptive act to refuse to permit a transfer of a franchise without good cause. To determine good cause the legislation considers, among other things, whether the proposed transferee fails to meet the franchisor's reasonable qualifications or standards, whether the proposed transferee is a competitor of the franchisor, the inability or unwillingness of the proposed transferee to agree in writing to comply with and be bound by all lawful obligations imposed by the franchise, and the failure of the franchisee or proposed transferee to pay any sums owing to the franchisor and to cure any default in the franchise agreement at the time of the proposed transfer. In Arkansas, Nebraska, and New Jersey the franchise relationship laws go further and impose specific transfer procedures on both franchisor and franchisee. The procedure requires a franchisee to provide a franchisor with both notice and details of any proposed transfer. The franchisor must then approve the transfer or provide the material reasons why consent to a transfer is being withheld, based upon the character, financial ability, or business experience of the proposed transferee.

The approach in Australia is largely similar to that of the United States. The *Franchising Code* provides that the franchisor may not unreasonably withhold consent to a transfer and

provide specific instances where it would be reasonable for a franchisor to withhold consent, including, for example, where the proposed transferee is unlikely to be able to meet the financial obligations under the franchise agreement, does not meet a reasonable requirement of the franchise agreement, has not met the selection criteria of the franchisor, or does not agree in writing to comply with the obligations of the franchisee under the franchise agreement. The franchisor can also withhold consent where the agreement to the transfer would have a significantly adverse affect on the franchise system, the franchisee has not paid or made reasonable provision to pay an amount owing to the franchisor, or the franchisee has breached the franchise agreement and has not remedied that breach. In Canada, the duty of good faith and commercial reasonableness probably imposes the same standard.

## **7.8 Quality Control Rights of the Franchisor**

Relationship laws in some jurisdictions contain quality control rights in favour of the franchisor. These laws are aimed at protecting a franchisor's trade-mark and other intellectual property rights, such as goodwill and reputation in the community but do not necessarily rely on trade-mark protection or other intellectual property rights. Rather, they create a baseline standard for franchisee conduct which can be read into every franchise agreement. In general, quality control standards require a franchisee to ensure the proper quality in operating the franchise business, selling products, providing services, and in all marketing and advertising. Under the Russian *Civil Code* these rights are referred to as the user's obligations, and require a franchisee to ensure compliance with the quality of goods on the basis of the contract and similar works of the right holder. The Lithuanian approach is to require franchisees to ensure proper quality of goods manufactured, work performed, or services rendered. In Estonia, the *Law of Obligations Act* requires a franchisee to maintain the quality of goods and services and provide appropriate additional services required or expected by local customers. The *Fair Franchise Transactions Act* in South Korea similarly requires franchisees to maintain the uniformity of the franchise and good reputation of the franchisor. Lastly, Article 142 of the *Industrial Property Law*<sup>37</sup> in Mexico allows a franchisor to interfere in a franchised outlet to ensure that the image and standards of the franchise are respected.

## **7.9 The Duty of Confidentiality**

Confidentiality covenants are an integral part of any franchise agreement and, unlike non-compete clauses, typically last for an indefinite period. Simply put, such covenants compel the franchisee, and in some instances, his or her principals, associates, and employees, to keep trade secrets, commercial information, and know-how confidential both during and after the franchise relationship. Countries such as China, Malaysia, Russia, Lithuania, Ukraine, Belarus, Moldova, Georgia, and Italy all impose a duty of confidentiality on a franchisee. Russia, Lithuania, Ukraine, Belarus, Moldova, Georgia, China, and Italy all impose a general obligation on the franchisee to keep commercial secrets confidential. The duty is somewhat more onerous in Malaysia requiring a franchisee to provide the franchisor with a written guarantee that the franchisee and his employees will not disclose confidential information.

## **7.10 The Right to Associate**

A franchisee's right to form an association is a popular concept in North America. In the United States, for example, Arkansas, California, Hawaii, Illinois, Iowa, Michigan, Minnesota, Nebraska, New Jersey, and Washington all prohibit a franchisor from restricting the right of free association among franchisees for any lawful purpose. In Canada, all five of the franchise statutes prescribe the right to freedom of association among franchisees. The Australian *Franchising Code of Conduct* has similarly followed suit and contains a provision explicitly

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<sup>37</sup> *Industrial Property Law*.

prohibiting a franchisor from inducing franchisees or prospective franchisees not to form an association or associate with other franchisees or prospective franchisees for a lawful purpose. A similar right is also found in Moldova.

Simply put, the right to associate allows franchisees to come together and collectively express, promote, and pursue common interests. The right is grounded in the need to level the contractual playing field between franchisor and franchisee during the term of the agreement when the franchisor reserves extensive powers to change unilaterally the economic basis of the business. If franchisees have the right to associate they could obtain sophisticated advice and stand in a more balanced position in keeping ill conceived or opportunistic initiatives in check. In Ontario, a recent decision out of the Court of Appeal found that the franchisees' statutory right to associate includes the right to engage in a class proceeding to enforce their rights under the legislation or otherwise.<sup>38</sup> In reaching its decision the Court highlighted the importance and purpose of franchise legislation and endorsed the holding of a trial court finding that it "would be inexplicable if it [the right to associate] was not intended to permit franchisees to associate for the purpose of protecting their interests and enforcing their rights through collective action."<sup>39</sup> That said, franchise associations are not indomitable unions and while franchisors cannot prohibit associations, there is nothing in the legislation requiring a franchisor to recognize or deal with an association.

### **7.11 Reasonable Restraints on Competition**

The franchise model involves fundamentally the grant of a right by the franchisor to the franchisee to carry on business under its trade-mark and business system in exchange for financial consideration. By its very nature, the franchise model requires the franchisor to share its confidential information and know-how with the franchisee. This transfer of confidential information can often leave the franchisor vulnerable should the franchisee choose to use the franchisor's know-how in the pursuit of a similar competing business system. For this reason, some jurisdictions have enacted relationship laws explicitly restraining post-term competition. For example, in Albania, Moldova, Georgia, and Malaysia, once the relationship has ended the franchisee is prohibited from competing with the franchisor in the local market. The period of restraint ranges from one year in Albania, Moldova, and Georgia to two in Malaysia. Similarly, the Russian, Ukrainian, and Belarusian *Civil Codes* expressly prohibit a franchisee from competing with the franchisor on the territory. The *Codes*, however, are silent with respect to whether the prohibition applies during or post term. In most jurisdictions non-compete clauses must be reasonable, while others prohibit them all together. Further, under the common law in Canada non-compete clauses cannot offend public policy and must be described with sufficient particulars, duration, and geographical scope.

### **7.12 Dispute Resolution**

Some jurisdictions, such as the Canadian Provinces with franchise legislation, several of the U.S. states, Australia, South Africa, and Italy impose certain requirements concerning dispute resolution. For example, the Canadian Provinces with franchise legislation, several state registration statutes, and the South African *Consumer Protection Act* all provide for specific jurisdiction rights which can be read into every franchise agreement. With respect to the venue for dispute resolution, both the States of Michigan and Washington require arbitration or litigation to be conducted outside the state. More generally, the United States *Federal Arbitration Act*<sup>40</sup> pre-empts any restriction on the right to arbitrate imposed in state legislation, although recently some franchise arbitration provisions have come under attack for being "unconscion-

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<sup>38</sup> 405341 *Ontario Limited v. Midas Canada Inc.*, 2010 ONCA 478.

<sup>39</sup> 405341 *Ontario Limited v. Midas Canada Inc.*, 2009 CanLII 56298 (Ont. Sup. Ct.) at para. 17.

<sup>40</sup> *Federal Arbitration Act*, 9 U.S.C. §§ 1-14.

able” under the state laws.<sup>41</sup> In Italy, the franchisor and franchisee may choose their jurisdiction and arbitral tribunal. The parties may also agree that any disagreement must go through the relevant Chamber of Commerce and Industry prior to proceeding to court or arbitration.

The franchise legislation in Australia, South Korea, and the Provinces of New Brunswick and Manitoba provide for mediation as an option for dispute resolution. In Australia, for example, Part 4 of the *Franchising Code of Conduct* provides a dispute resolution scheme for parties to a franchise agreement. Where the franchisor and franchisee are unable to resolve a dispute within three weeks, either party may refer the matter to mediation. When a party refers a matter to mediation the process becomes mandatory. In South Korea, Article 16 of the *Fair Franchise Transactions Act* provides for the establishment of a Franchise Dispute Mediation Council (the “Council”) under the control of the Korea Fair Trade Mediation Agency. The Council mediates disputes over franchise transactions as requested by the Fair Trade Commission or by the parties in dispute. The Council may advise the parties in dispute to settle the matters between themselves or may prepare and present a dispute mediation proposal. Contrast this to the Province of New Brunswick which allows a party to decline mediation if that party is of the opinion that the dispute is not suitable for mediation. In New Brunswick the mediation process is governed by *Mediation Regulation – Franchises Act*.<sup>42</sup> Lastly, in the Province of Manitoba if the franchise agreement provides that disputes may be referred to or resolved by mediation or arbitration, the disclosure document must include information about mediation procedures and arbitration proceedings. Mediation can be beneficial to both franchisor and franchisee even in jurisdictions without specific mediation provisions and is a proven cost-effective way to resolve franchising disputes.

### **7.13 Discrimination and Encroachment**

Relationship laws dealing with discrimination generally prohibit a franchisor from discriminating between franchisees in the charges for royalties, goods, services, equipment, rentals, advertising services, or in any other business dealing, unless such discrimination is based on reasonable distinction and is not arbitrary. Discrimination among franchisees is expressly prohibited in several states in the U.S., South Korea, and Malaysia. Encroachment happens when a franchisor directly or indirectly (e.g., through another franchisee) provides products and/or services into the territory assigned to the franchisee, where such activities are not explicitly prohibited in their franchise agreements. Some states in the United States prohibit encroachment of the franchisee’s trade area but will look to whether or not the franchisee was granted any form of exclusivity. In Russia encroachment is prohibited under the *Civil Code*. In South Korea, encroachment is prohibited under Article 5, items to be observed by franchisor. In Canada, both discrimination and encroachment likely fall within the duty of good faith and fair dealing.

### **7.14 Liability**

Some jurisdictions, such as Russia, Ukraine, Belarus, Italy, and the Provinces of Alberta and Ontario have included provisions in their legislation dealing with the liability of the franchisor for claims made by third parties against the franchisee. For example, in Russia the franchisor will bear subsidiary liability for claims relating to inconsistencies in the quality of goods sold by the franchisee, and joint liability for claims relating to the manufacturing of the products. Similar provisions are found in both the Belarusian and Ukrainian *Civil Codes*. In Italy and Canada, a franchisor may be held vicariously liable for the negligent acts of its franchisee where the consumer thinks it is dealing with a branch of the franchisor and not with an independent party.<sup>43</sup>

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<sup>41</sup> *Nagrampa v. MailCoups Inc.*, 469 F.3d 1257 (9th Cir. 2006).

<sup>42</sup> *Mediation Regulation – Franchises Act*, N.B. Reg. 2010-93.

<sup>43</sup> *Leahy v. McDonald’s Restaurants of Canada Ltd.*, [1993] O.J. No. 2226 (Gen. Div.) (QL), *Beuker v. H&R Block Canada Inc.*, [2001] 10 W.W.R. 274 (Sask. Q.B.).

## 7.15 Language Requirements

Generally, relationship laws do not have express language requirements. Only four jurisdictions have explicit language requirements, namely, Italy, Vietnam, Indonesia, and the Province of Quebec. In Quebec, however, while the *Charter of the French Language*<sup>44</sup> compels the use of the French language, parties can agree in writing that another language be used. The practical reality, however, is that using the language of the jurisdiction (alongside with the franchisor's native language) is often necessary to comply with the disclosure requirements, to obtain government registration or approval, or to enforce the contract in the franchisee's jurisdiction when the time comes. Further, drafting franchise agreements in the language of the jurisdiction is prudent due to an inability, in most instances, to otherwise enforce the contract.

## 8. Other Considerations

### 8.1 Industry-Specific Legislation

In addition to specific franchise relationship laws, several North American jurisdictions have enacted industry-specific legislation that governs franchisor relationships in product distribution franchises within specific industries. While varying depending on the jurisdiction, these statutes generally require good faith in performing the agreement, good cause for termination or failure to renew, buy-back protection, enhanced transfer and assignment rights, disclosure, and protection from discrimination. A detailed analysis of these industry-specific statutes is beyond the scope of this paper; the following, however, is a non-exhaustive overview of this mostly North American trend.

By way of example only, in New Jersey, the motor vehicle section of the *Franchise Practices Act*<sup>45</sup> recently underwent major amendment. These amendments, which became law on May 4, 2011, target motor vehicle franchise abuse stemming largely from the recent insolvencies of the number 1 and 3 car factories in North America. Broadly stated, the amendments:

- expand the list of prohibited practices;
- clarify the manufacturer's obligation to repurchase inventory on termination or cancellation;
- create minimum warranty reimbursement rates;
- introduce automatic injunctive relief against termination; and
- modify dealer protest rights and procedures.

To expand, the newly created prohibited practices include such things as:

- prohibiting discrimination between dealers based on price, allocation, and product availability;
- limiting the ability of a manufacturer to impose conditions on the transfer of a franchise; and
- limiting the ability of a manufacturer to amend or modify the franchise agreement except in good faith and for good cause, and where such a modification would not substantially alter the rights, obligation, investment, or return on investment of the franchisee.

Further, the amendments to section 13 clarify a manufacturer's obligations to repurchase inventory from a franchisee upon termination and make it a violation for a manufacturer to terminate

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<sup>44</sup> *Charter of the French language*, R.S.Q., c. C-11.

<sup>45</sup> *Franchise Practices Act*, N.J.S.A. 56:10-1, *et seq.*

a franchise (without proper compensation) due to the discontinuation of a line. The new warranty provisions now require minimum warranty parts reimbursement rates for recreation motor vehicle franchisees. With respect to injunctive relief, the amended statute now includes a section providing for an automatic injunction against a termination when there is the timely institution of an action or alternative dispute resolution proceedings based on an allegation that the termination violates the act. Further, the amendments broaden the ability of an existing dealer to protest a manufacturer's appointment of an intra-brand competitor within a "relevant market area." The "relevant market area" has been expanded to include all dealers within 14 miles of the proposed new dealer site. The "relevant market area" for relocations, however, remains unchanged. Lastly, the amendments to the protest provisions limit the right of a manufacturer to reopen or reactivate a closed franchise. Section 20 now not only incorporates restrictions based on time and mileage, but also precludes an assignee of, or successor to, a franchisor from exercising such rights at all.

Also notable, are two new laws in both Alabama and Texas. Specifically, Alabama has recently approved a new law that regulates the relationships between recreational vehicle manufacturers and dealers. Bill HB341, which became law on October 1, 2011, provides buy-back protection, warranty reimbursement, and provisions for dealership transfers. Similarly, the State of Texas has recently amended its boat dealers law. Bill HB 1960, which became law on September 1, 2011, covers issues such as dealer territory, warranty work, and performance standards. The amendments also eliminate the good cause for termination requirement and replace it with a prohibition on termination absent dealer default. Various other states have enacted industry-specific statutes affecting heavy equipment, petroleum or motor fuel franchises, service stations, agricultural equipment, insurance, watercraft and outboard motors, and trailers.

While industry-specific legislation is primarily seen as a U.S. trend, in Canada several Provinces have had long standing farm implements legislation, recently updated, and offering limited protection to farmers who purchase farm implements from dealers, and limited protection to those dealers in relation to their suppliers. Saskatchewan's *Agricultural Implements Act*,<sup>46</sup> for example, is fairly typical of this type of legislation. Essentially, SAIA's dealer protection component permits either the dealer or its supplier/manufacturer to require the supplier to repurchase unused machinery, implements, and marketing materials where the agreement is terminated for any reason. Ontario's *Farm Implements Act*<sup>47</sup> similarly offers dealers buy-back protection, as well as renewal and transfer rights and protection from exclusivity clauses and unfair or unreasonable sales targets. The OFIA also creates an alternative dispute resolution process to resolve, among other things, certain types of disputes between a dealer and its supplier or a manufacturer. The Alberta *Farm Implements Act*<sup>48</sup> also offers dealers substantially the same buy-back protection as does the SAIA and the OFIA, but in addition allows either the dealer or the distributor to apply to the Farm Implements Board for compensation out of the Farm Implement Compensation Fund for any loss arising from the other's breach of FIA. In 2001, Alberta also enacted the *Farm Implement Dealerships Act*<sup>49</sup> which requires a distributor to have cause to terminate a dealership agreement and prohibits discrimination among dealers.

## 8.2 Self-Regulation

Numerous country specific and one regional franchise association have adopted franchise codes of conduct designed to govern their franchise members during the franchise relationship as a condition of association membership.<sup>50</sup> For example, franchise groups such as the

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<sup>46</sup> *Agricultural Implements Act*, R.S.S. 1978, c. A-10 ["SAIA"].

<sup>47</sup> *Farm Implements Act*, R.S.O. 1990, c. F 4 ["OFIA"].

<sup>48</sup> *Farm Implements Act*, R.S.A. 2000, c. F-7 ["FIA"].

<sup>49</sup> *Farm Implement Dealership Act*, S.A. 2001, c. F-7.5 ["FIDA"].

<sup>50</sup> For example, the World Franchise Council's Principles of Ethics; the International Franchise Association's Code of Ethics; the Japanese Franchise Association Code of Ethics; the Code of Ethics of the European Franchising Fed-

World Franchise Council (“WFC”) and the International Franchise Association (“IFA”) have included codes of ethics as part of their self-regulation programs. The WFC’s Principles of Ethics, for instance, are based on the common principles and experiences of its member countries<sup>51</sup> and describe “good professional conduct” amongst the actors in franchising.<sup>52</sup> Similarly, the IFA Code of Ethics establishes a framework for the implementation of best practice in the franchise relationship. It represents the “ideals to which all IFA members agree to subscribe in their franchise relationship.”<sup>53</sup> The IFA’s self-regulation program goes even further and includes an Ombudsman to help identify, facilitate, and encourage the early resolution of disputes that arise.

In practical terms, these codes are useful tools for both franchisor and franchisee but are not intended to address every issue. Like most self-regulation models these codes are not a substitute for regulation and have no force of law, but rather provide recommendations and guidelines for how best to resolve disputes. The voluntary nature of these codes also renders them largely ineffective as their application is limited to members and the worst consequence for violation is likely expulsion and, possibly, breach of contract claims. That said, when a dispute arises, it will be important to review these codes as they may ultimately influence a court’s decision-making process as evidence of custom and usage and courts may even impute code obligations into the contract under review.

### 8.3 The Commissioner Model

In a very recent development, both South Australia (“SA”) and Western Australia (“WA”) have State Bills at advanced stages of the legislative approval process. The SA bill is anticipated to become law in late 2011 and the WA bill is at the Committee stage of the approval process. Both the WA and SA franchising bills are intended to strengthen the existing regulatory framework and provide enhanced protection for franchisees. The bills empower the Small Business Commissioner to investigate, prosecute, and impose fines for any breach of a number of codes including the *Franchising Code of Conduct*. If passed, the bills will also impose a general duty to deal fairly and in good faith. The debate on the issue is no different: opponents of the bills fear the new law will bring down the franchising sector and result in the end of freedom of contract. Proponents, on the other hand, believe the laws will create a level playing field and allow franchisees to protect their rights and interests. If passed, the bills will herald more support for the shift to relationship laws in franchise regulation.

## 9. Conclusions and Lessons Learned

While the franchise model continues to be a successful vehicle for business investment, it brings with it many relationship challenges. As already discussed, franchise agreements are contracts of adhesion and as such statutory intervention is necessary to mitigate and alleviate the power imbalance that exists between franchisors and franchisees. Many jurisdictions have already come to realize this need and have taken ownership of ensuring some level of protection for franchisees who are often small business people without the resources or sophistication to effectively challenge franchisor opportunism. One of the first attempts to level the playing

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eration; the Franchising Council of Australia Member Standards; the Canadian Franchise Association Code of Ethics; and the Franchise Association South Africa Code of Ethics and Business Practices.

<sup>51</sup> Argentina, Australia, Austria, Belgium, Brazil, Canada, China, Czech Republic, Denmark, Ecuador, Egypt, Finland, France, Germany, Greece, Hong Kong, Hungary, India, Italy, Japan, Kazakhstan, Lebanon, Malaysia, Mexico, Netherlands, New Zealand, Philippines, Portugal, Russian Federation, Singapore, Slovenia, South Africa, Sweden, Switzerland, Taiwan, Turkey, United Kingdom, and the United States.

<sup>52</sup> *The WORLD FRANCHISE COUNCIL’s Principles of Ethics*, online: World Franchise Council <[http://www.worldfranchisecouncil.org/control/cpview?contentId=WFC\\_RULES](http://www.worldfranchisecouncil.org/control/cpview?contentId=WFC_RULES)>.

<sup>53</sup> *Code of Ethics*, online: International Franchise Association <<http://www.franchise.org/industrysecondary.aspx?id=3554>>.

field was through the use of mandatory disclosure requirements. While important, as time progressed and some franchisors continued to behave opportunistically, it became obvious that disclosure laws alone were inadequate in protecting franchisees throughout the ongoing business relationship. As a result, many jurisdictions introduced relationship laws aimed at regulating the core of the franchise model, that is, the contract. These laws, unlike disclosure laws, override certain contractual provisions by mandating standards of conduct and circumscribing certain franchisor rights.

Given the growth and penetration of the franchise business model, in mature as well as emerging markets, there is little doubt that opportunistic behaviour will be restrained by increasing amounts of both pre and post sale regulation. One could hope that with increased regulation it would follow in principle, if not in form, some uniformity across borders. In furtherance of that objective, it might be worth it for UNCITRAL or perhaps a committee of this group to draft a principled and balanced model regulatory guide for jurisdictions seeking, as they will do, to regulate this dynamic industry.<sup>54</sup>

So what can we conclude going forward? First, franchise laws with relationship requirements already exist in a number of countries, many of which are “top priority markets” for international franchisors. These laws will likely expand into other countries. Franchisors should take note. Second, while specific “franchise relationship only” laws are confined to a few jurisdictions, there are other bodies of law that will affect the franchise relationship, and franchisors will be well advised to take those into account in preparing their franchise agreements. Lastly, it should be emphasized that franchise relationship laws by-and-large do not impose requirements that are so burdensome they would deter a franchisor from entering into franchise agreements. Thus, while certain structuring techniques, such as, off-shore structuring, bifurcating agreements, etc. may be useful in overcoming certain regulatory hurdles, the authors do not believe that franchisors in most cases need to, or should, use these techniques to try to circumvent the franchise relationship laws. Complying with these laws in most instances is not difficult, and alternative structures may impair a franchisor’s ability to enforce its rights in the future.

## **10. Author Biography**

Mr. John Sotos is the founding partner of Sotos LLP and practices in the area of Canadian franchising, licensing, and distribution law with a large national and international client base. He has extensive experience in franchise system development, repositioning, insolvencies, and complex litigation, including class actions. Mr. Sotos also instructs internationally on franchising as a vehicle for economic growth and has co-chaired the Uniform Law Conference of Canada franchise law project as well as the Franchise Working Sector Team advising the Ontario Government on franchise industry management.

Mr. Sotos obtained his Bachelor of Arts from the University of Toronto in 1975 and his Bachelor of Laws from the University of Western Ontario in 1978 and is currently listed in the International Who’s Who of Franchise Lawyers, Lexpert and Leading 500 Lawyers in Canada, [www.BestLawyers.com](http://www.BestLawyers.com), and has attained the highest rating in Martindale-Hubbell.

Mr. Sotos serves on the Board of numerous corporations and charities, including the Toronto East General Hospital Foundation Board of Directors, the Planned Giving Committee,

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<sup>54</sup> A similar objective has already been undertaken by UNIDROIT in 1998 and again in 2007, with the publication of its *Guide to International Master Franchise Arrangements*. The guide offers a comprehensive examination of master franchise arrangements, from the negotiation and drafting of the agreement to the end of the relationship and its effects.

and the Hellenic Heritage Foundation. He has also served on the editorial board of industry and professional publications and serves as special counsel to a number of franchisors and associations.

Mr. Sotos is a member of the Law Society of Upper Canada, the Canadian Bar Association, the American Bar Association, The International Bar Association, the Canadian Franchise Association and the International Franchise Association.

**Schedule A  
Quick Reference**

	AUSTRALIA	INDONESIA	MALAYSIA	CHINA	JAPAN	MACAU	SOUTH KOREA	VIETNAM	SOUTH AFRICA
Mandatory content		X	X	X		X	X		X
Cooling-off	X		X	X					X
General standards of conduct			X	X	X	X	X		X
Breach of contract	X								
Term/renewal			X	X		X	X		
Termination	X	X	X	X	X	X	X	X	
Transfer	X					X		X	
Dispute resolution	X						X		X
Provide support	X	X	X	X		X	X		
Other	<ul style="list-style-type: none"> <li>• Right to associate</li> <li>• Marketing funds</li> </ul>		<ul style="list-style-type: none"> <li>• Confidentiality</li> <li>• Competition</li> </ul>	<ul style="list-style-type: none"> <li>• Confidentiality</li> <li>• 2+1 rule</li> </ul>		<ul style="list-style-type: none"> <li>• Confidentiality</li> <li>• Competition</li> </ul>	<ul style="list-style-type: none"> <li>• Non-compete obligation of the franchisor</li> <li>• Quality of goods obligation on franchisee</li> </ul>	<ul style="list-style-type: none"> <li>•</li> </ul>	<ul style="list-style-type: none"> <li>• Treats franchisee as consumer</li> </ul>

	KAZAKHSTAN	ESTONIA	LITHUANIA	ITALY	ROMANIA	ALBANIA	BELARUS	GEORGIA	UNITED STATES
Mandatory content	X				X		X		
Cooling-off							X		
General standards of conduct		X							AR, HI, IA, MN, WA
Breach of contract									
Term/renewal			X	X	X				AR, CA, CT, DE, HI, IL, IN, IA, MI, MN, MS, MO, NE, NJ, WA, WI, PR, VI
Termination			X	X		X	X		AR, CA, CT, DE, HI, IL, IN, IA, MI, MN, MS, MO, NE, NJ, RI, VA, WA, WI
Transfer				X					AR, CA, HI, IN, IA, MI, MN, NE, NJ
Dispute resolution									MI, WA, CA, CT, DE,
Provide support	X	X	X		X	X	X		
Other	<ul style="list-style-type: none"> <li>Confidentiality as to information received from franchisee</li> </ul>	<ul style="list-style-type: none"> <li>Quality of goods obligation on franchisee</li> </ul>	<ul style="list-style-type: none"> <li>Quality of goods obligation on franchisee</li> <li>Confidentiality</li> <li>Competition</li> </ul>	<ul style="list-style-type: none"> <li>Confidentiality</li> </ul>	<ul style="list-style-type: none"> <li>Confidentiality</li> <li>Competition</li> </ul>	<ul style="list-style-type: none"> <li>Competition</li> </ul>	<ul style="list-style-type: none"> <li>Special liability of the franchisor</li> <li>Quality of goods obligation on franchisee</li> </ul>	<ul style="list-style-type: none"> <li>Confidentiality</li> <li>Competition</li> </ul>	<ul style="list-style-type: none"> <li>Right to associate: AR, CA, HI, IL, IA, MI, MN, NE, NJ, WA</li> <li>Competition: IN, MI, MN</li> </ul>

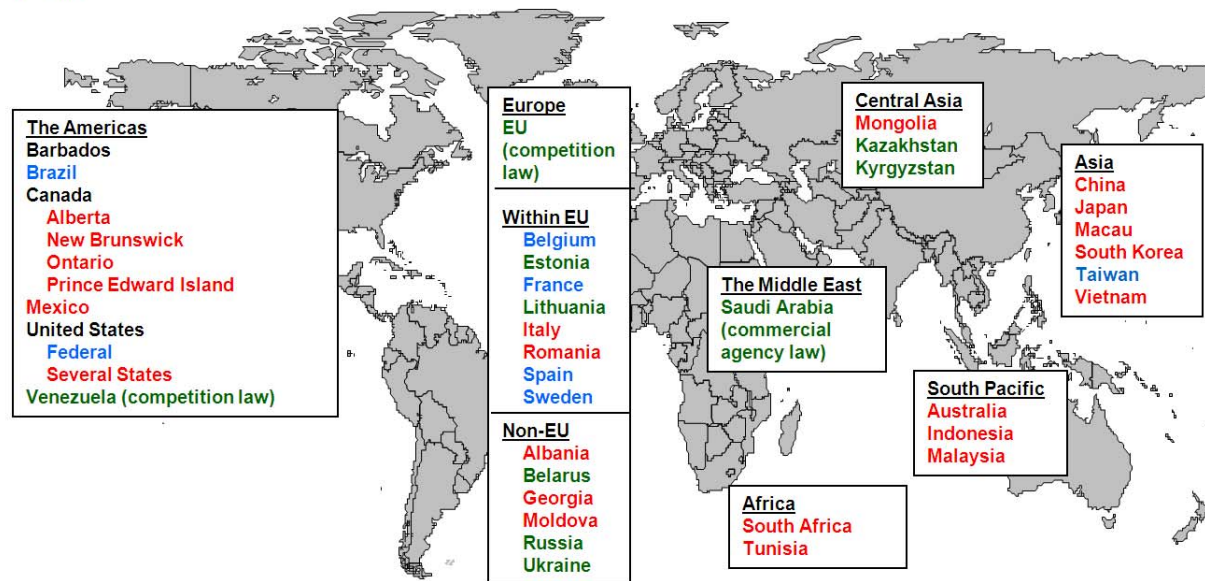
	MOLDOVA	RUSSIA	UKRAINE	ALBERTA	NEW BRUNSWICK	ONTARIO	PRINCE EDWARD ISLAND	MANITOBA (NOT YET IN FORCE)	MEXICO
Mandatory content	X	X	X						X
Cooling-off		X	X						X
General standards of conduct				X	X	X	X	X	X
Breach of contract			X						X
Term/renewal	X	X	X						
Termination	X	X	X						X
Transfer		X	X						
Dispute resolution					X			X	
Provide support	X	X							
Other	<ul style="list-style-type: none"> <li>Confidentiality</li> <li>Competition</li> </ul>	<ul style="list-style-type: none"> <li>Quality of goods obligation on franchisee</li> <li>Confidentiality</li> <li>Competition</li> <li>Comprehensive regulations</li> </ul>	<ul style="list-style-type: none"> <li>Comprehensive regulations</li> <li>Quality of goods obligation on franchisee</li> <li>training</li> </ul>	<ul style="list-style-type: none"> <li>Right to associate</li> </ul>	<ul style="list-style-type: none"> <li>Right to associate</li> </ul>	<ul style="list-style-type: none"> <li>Right to associate</li> </ul>	<ul style="list-style-type: none"> <li>Right to associate</li> </ul>	<ul style="list-style-type: none"> <li>Right to associate</li> </ul>	<ul style="list-style-type: none"> <li>Quality of goods obligation on franchisee</li> </ul>

## Schedule B

# Laws Applicable to Franchising June 2011

EVERYTHING MATTERS

Blue = Disclosure Law  
Green = Relationship Law  
Red = Disclosure & Relationship Laws  
Black = Other



### Does Not Include:

- Codes of conduct which do not provide for governmental or private enforcement, even if promulgated under governmental authority.
- Bodies of law (e.g. competition, intellectual property, etc.) which also cover franchising, unless explicitly mentioned.



## Table of Authorities

### LEGISLATION

- Agricultural Implements Act*, R.S.S. 1978, c. A-10.  
Ark. Stat. Ann. § 4-72-201 *et seq.* (1996).  
*Arthur Wishart Act (Franchise Disclosure) 2000*, S.O. 2000 c. 3.  
*Belorussian Civil Code*, Chapter 53 (Articles 910 - 910-11).  
Cal. Bus. & Prof. Code § 20000 *et seq.* (1987).  
*Charter of the French language*, R.S.Q., c. C-11.  
*Consumer Protection Act* (Act No. 68 of 2008) (South Africa).  
Conn. Gen. Stat. § 42-133e *et seq.* (1987).  
*Decree No. 35/2006/ND-CP and Circular No. 09/2006/TT-BTM*.  
Del. Code Ann. Tit. 6 § 2551 *et seq.* (1975).  
*Fair Franchise Transactions Act*, amended in part on 2007, Law No. 8630 (South Korea).  
*Farm Implements Act*, R.S.O. 1990, c. F 4.  
*Farm Implements Act*, R.S.A. 2000, c. F-7.  
*Farm Implement Dealership Act*, S.A. 2001, c. F-7.5.  
*Federal Arbitration Act*, 9 U.S.C. §§ 1-14.  
*Franchises Act 1998*, Act 590 (Malaysia).  
*Franchises Act*, R.S.A. 2000, c. F -23.  
*Franchises Act*, R.S.P.E.I. 1998, c. F-14.1.  
*Franchises Act*, S.N.B. 2007, c. F-23.5.  
*Franchises Act*, S.M. 2010, c. 13.  
*Franchising Code of Conduct* (Australia).  
*Franchise Practices Act*, N.J.S.A. 56:10-1, *et seq.*  
*Georgia Civil Code*, Article 607-614.  
*Government Regulation No. 42 of 2007* (Indonesia).  
Haw. Rev. Stat. § 482E *et seq.* (1985).  
Ill. Rev. Stat. § Ch. 815, § 705/20 (1992).  
Ind. Code § 23-2-2.5 *et seq.* (1999).  
*Industrial Property Law* (Mexico).  
Iowa Code Ann. §§ 523H *et seq.* (1998).  
*Law of Obligations Act* (Estonia).  
*Mediation Regulation – Franchises Act*, N.B. Reg. 2010-93.  
Mich. Comp. Laws Ann. § 445.1527 (West 1989).  
Minn. Stat. § 80C.01 *et seq.* (1989).  
Miss. Code Ann. § 75-24-51 *et seq.* (1999).  
Mo. Ann. Stat. § 407.400 *et seq.* (1979).  
*Moldova Civil Code*, Chapter XXI (Articles 1171-1178).  
*Moldova Law on Franchising*, No. 1335 dated 1 January 1997, as amended.  
Neb. Rev. Stat. § 87-401 *et seq.* (1994).  
N.J. Rev. Stat. § 56:10-1 *et seq.* (1994).

*People's Republic of China Civil Code.*  
*Regulation on the Administration of Commercial Franchises* (No. 485 of 2007, China).  
*Regulation of the Minister of Trade* No. 31/M-DAG/PER/8/2008.  
*Russian Civil Code*, Chapter 54 (Articles 1027-1040).  
*Ukrainian Civil Code*, Chapter 76 (Articles 1115-1129).  
Wash. Rev. Code § 19.100.010 *et seq.* (1999).  
Wis. Stat. § 135.01 *et seq.* (1989).  
P.R. Laws Ann. Tit. 10 § 278 *et seq.* (1994).  
V.I. Code Ann. Title 12A., Chptr. 2, Subchptr III, §§ 130-139.

## **JURISPRUDENCE**

*405341 Ontario Limited v. Midas Canada Inc.*, 2010 ONCA 478.  
*405341 Ontario Limited v. Midas Canada Inc.*, 2009 CanLII 56298 (ON SC).  
*Beuker v. H&R Block Canada Inc.*, [2001] 10 W.W.R. 274 (Sask. Q.B.).  
*Carvel Corporation v. Baker*, 79 F. Supp. 2d 53 (D. Conn 1997).  
*Leahy v. McDonald's Restaurants of Canada Ltd.*, [1993] O.J. No. 2226 (Gen. Div.).