Franchising in the Shadow of Contract Law: A New Fidelity for Business Relations

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The institution of franchising has experienced a remarkable growth in North America in recent years. This has provoked a variety of legislative and judicial responses. This article examines the reasons behind the rise of franchising. It proceeds to examine the principal models of statutory regulation of franchise arrangements, and also the range of common law doctrines which courts have brought to bear on disputes arising out of such contracts. The author points out deficiencies in the existing models of franchise regulation and, drawing on legal responses to family disputes, proposes an alternative.

Introduction

Franchising is a hydra-headed corporate invention, defying simple description—it is at once a sophisticated form of trade-mark licensing, a contractual alternative to corporate vertical integration, a low-risk

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1. This title is a play on R.H. Mnookin & L. Komhauser, “Bargaining in the Shadow of the Law: The Case of Divorce” (1979) 88 Yale L.J. 950. As I discuss in this paper, the developments in family law may prove useful for analyzing and developing legal strategies in franchising law (see infra Part IV).


method of accumulating capital\textsuperscript{4} and a marketing technique for distributing products or services.\textsuperscript{5} It has been lauded as a business saviour for minority entrepreneurs\textsuperscript{6} and promoted as a corporate vehicle where franchisor and franchisee can both contribute value for their mutual benefit.\textsuperscript{7} Unlike a bare license, where there is little or no control exercised over the licensee, or an employment contract, where control over employees can be excessive, there is a more subtle exercise of control in franchising.\textsuperscript{8}

The legal definition of franchise is equally ephemeral. Franchising laws, adopted in a number of jurisdictions in the United States (as well as Alberta), vary widely and are frequently modified.\textsuperscript{9} In other provinces (and states without franchising legislation), the definition has developed jurisprudentially.\textsuperscript{10} Curial deference to the wiles of commercial lawyers lends credence to the courts’ general reluctance to close the category of franchise, so that each franchise agreement is still judged on its own terms and conditions.\textsuperscript{11}

9. Compare the definition of franchise in California with the definition used in the Franchises Act, R.S.A. 1980, c. F-17. Alberta supposedly adopted its original franchising act from California, yet the definitions are quite different. In its most recent form, the Franchises Act, S.A. 1995, c. F-17.1 (see infra at note 86 and accompanying text) the definition was revised as it was apparent some franchisors circumvented the act simply by masking the fees payable by franchisees.
10. See for example Magnetic Marketing Ltd. v. Print Three Franchising Corp. (1991), 4 B.L.R. (2d) 8 (B.C.S.C.); 387071 Ontario Ltd., v. 526770 Ontario Ltd. (1988), 66 O.R. (2d) 167 (H.C.J.). In the latter case, the franchisee argued that it should be an implied term of a franchise agreement that the franchisor will advertise, train, specify ingredient types, supply uniforms, etc. It was the franchisee’s position that there was no requirement to pay royalties because the franchisor failed to comply with these implied provisions. The Court stated that franchising is a business organization having a variety of forms; in this case the franchisee knew or ought to have known at the outset of the relationship exactly what was expected of the franchisor. It is clear that there was extreme hesitancy on the Court to extend the ambit of implied terms and judicially create a definition of franchising.
11. See 387071 Ontario Ltd., ibid. Also see Bawitko Investments Ltd. v. Kernels Popcorn Ltd. (1991), 79 D.L.R. (4th) 97 (Ont. C.A.) where the Court, in determining whether a franchise
Franchising is largely a twentieth-century phenomenon. Although there is some dispute about the first use of franchising, it is generally recognized that the Singer Sewing Company developed it approximately 100 years ago. Fifty years later, Henry Ford started the first widespread use of franchising by developing distribution and sale networks for his Model T Ford automobiles. The marketing genius of Ford provided the catalyst for others, like soft drink bottling companies and gas station franchises. The fast food industry in the 1950s started the second wave of franchising where business format models proliferated. Today, franchising is ubiquitous, covering such diverse industries as convenience stores, auto parts and service shops, hotels, real estate agencies, personnel services, accounting firms, and others.

This unprecedented commercial growth in franchising is directly attributable to its success—whereas most independently formed businesses fail at a rate of 80 percent, franchises typically fail only 20 percent of the time. Franchising is now the predominant method of retail business expansion in Canada and the United States. Figures published by the Canadian Franchising Association estimate that in 1995, retail sales in Canada through franchising will reach approximately 77 billion dollars. This accounts for approximately 45 percent of all sales in Canada. A ten-fold increase in the number of franchised outlets in agreement was concluded prior to signing of a formal written document, stated that franchises are not conventional arrangements and therefore require specialized documentation, many items of which vary from agreement to agreement.
Canada was observed between 1979 and 1989. The statistics in the United States mirror those in Canada.

What are the reasons behind this staggering growth? In simple terms, franchisors and franchisees alike are seduced by the perceived benefits of franchising as compared with independent ownership. For the franchisor, these include growth with low capital outlay, cost sharing, maximizing profit and stability. For the franchisee, there is a belief that the commercial risks inherent in most business ventures are virtually nonexistent. This is due to a number of factors including the track record of a franchisor, the granting of relative independence (but with enough assistance, knowledge and expertise from the franchisor to ensure success), the use of ready-made intellectual property and therefore concurrent low initial outlay of capital and the collective buying power of a franchising system. Franchising has proven popular enough to engage discussion of franchising for law firms and farming, although neither of these proposals have, to my knowledge, been implemented.

Theoretically, a franchise allows a franchisor to achieve rapid growth with a minimum of capital expenditure, at the same time providing the benefit of profit-motive on the part of the franchisee. An ongoing revenue stream, in the form of initial fees and continuing royalties, provides access to rapid capital accumulation, while additional benefits, such as product pricing provisions and property leases, ensure additional control over the franchisee. In theory, the franchisee is motivated by a share in the profits, assured by the infrastructure of the franchise system of the ability to compete effectively with other large corporations.

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22. According to Davis, supra note 2, in 1980, total sales from franchises in the United States was 337.6 billion representing 36% of total sales. In 1980 there were 488,000 franchises, an increase of 6% over 1979. Davis cites figures showing that 41% of all U.S. foreign franchises are Canadian and that in 1978 there were 7,048 Canadian franchises owned by U.S. parents. This number has increased to 9,544 business format franchises in Canada in 1988 (see Trebilcock & Sutin, supra note 2 at 25).
23. See Gilbert & Jung, supra note 5. Of course, at the same time, there are associated risks. From the franchisor's point of view, franchisees are generally more independent and may be more difficult to control than employees. For franchisees, the restrictive operational practices imposed on them and complex, one-sided agreements may seem unfair. See also discussion at Part IV.
26. See J.A.H. Curry, Partners for Profit: A Study of Franchising (New York: American Management Association, 1966) at 33. Other commentators view the franchisee's motivation through profit as the essential element of a franchise, and a large contributing factor to the
Franchising relations will contain, in varying degrees, elements of trust, cooperation and reciprocity, alongside elements of coercion and dependence. The soundness of the relation between franchisor and franchisee depends to a large extent upon the control exercised by the franchisor. Even before an agreement is signed, common pre-contractual representations made by a franchisor provide evidence of the amount of control available to the franchisor.

This paper is divided into four parts. The first part consists of a brief review of some of the forms of legislation specific to franchising that have been adopted in North America and an overview of the history of this legislation. The second part examines common law remedies that are particularly apt for resolving franchising disputes: emphasis is given to implied standards of good faith in contracts and fiduciary obligations. There is also a brief discussion of the idea of self-regulation by franchise associations. Part three of the paper discusses the theoretical underpinnings of franchise governance models based on current relational and corporate group theories. It suggests analyzing franchise relationships by drawing analogies from family law and constructs an idea of a fidelity relation for franchising. The final part examines how the fidelity concept may be applied and looks at possible legislative or judicial action in this area.

I. Government Regulation of Franchising

1. The Forms of Legislation

a. Introduction

The first law specifically regulating franchising was enacted in the United States in the 1950s to protect automobile dealers. Thereafter came

success of franchising generally (See Makar, supra note 2, for example). Although it is outside the scope of this paper, I query why employee profit-sharing plans are not equally as effective or as popular.


2. Virtually all regulation relating specifically to franchising is found in North America. Australia has made attempts at regulating franchising; certain regulations under the Companies Code now include franchising arrangements. There are also the Petroleum Retail Marketing Franchises Act (1980) (Commonwealth) and the Estate Agents Act (Victoria) which indirectly regulate franchises in these specific areas. For a more detailed analysis, see I. Goddard, "Franchising Law: the Current Position" (1989) 63 Law Instit. J. 711.

individual state legislation, initially targeted at specific industries, followed by legislation dealing with franchising in general. Debate still rages about the efficacy of franchising laws; the discussion has become partisan. Recent developments throughout North America suggest the wishes of franchisors have prevailed. In the last decade, many states have amended their franchising legislation, reducing the protection given to franchisees. This backlash against franchise legislation has carried over into Canada and is reflected in some provinces rejecting proposed legislation. Nevertheless, as Stadfeld notes, in calling for increased government action:

Franchising is too important to be governed by contracts of adhesion unilaterally drafted by franchisors and often offered to franchisees on a take-it-or-leave-it basis. Despite their necessary and historically important contributions to franchising, few franchisees have meaningful rights in their long-term relationships with franchisors.

In the wake of the 1990 recession the need to adequately assess and reform egregious franchising practices has not gone unnoticed.

b. Forms of Legislation

Legislation governing franchises generally fits into three categories: disclosure, registration or relational. Disclosure and registration schemes require franchisors to prepare formal documents (usually referred to as statement of material facts or prospectus) that are submitted to franchisees along with the franchise agreement. Both these schemes are premised on the need to adequately assess and reform egregious franchising practices.
on the belief that with adequate data a prospective franchisee is able to make an informed decision on whether to enter into a franchise relation. Once this is determined, the franchise agreement governs the ongoing terms and conditions of the relation. Relational legislation affects the ongoing verities of the relationship between franchisor and franchisee. In these types of statutes, common law remedies are modified in order to strengthen a franchisee’s position. Some jurisdictions have created hybrid systems employing characteristics of each of the three schemes.\textsuperscript{36}

b.1 Disclosure

Disclosure schemes generally require a franchisor to prepare, for review by the franchisee, a prospectus or statement of material facts that includes all material information relating to the franchise.\textsuperscript{37} Sometimes there is a cooling off period to allow the potential franchisee time to reflect prior to committing itself to the relationship.\textsuperscript{38} If the prospectus is breached, there are often penal sanctions levied against the franchisor and its management,\textsuperscript{39} and franchisees are given civil remedies such as rights of rescission for material misrepresentations.\textsuperscript{40} Disclosure systems do not require the franchise prospectus to be filed with any governmental agency; rather, it is assumed that the franchisee will pursue any self-help remedies available to it in the event the franchise agreement is breached.

b.2 Registration\textsuperscript{41}

Registration schemes are similar to disclosure-only forms of legislation, but with increased governmental involvement. Under a registration scheme a sample prospectus must be filed and registered with an administrative agency prior to the selling of franchises. Typically, the agency is granted various powers to withhold registration based on the

\textsuperscript{36} See the original Franchises Act, R.S.A. 1980, c. F-17 (Alberta), supra note 9, for example [hereinafter 1980 Act].
\textsuperscript{37} The Franchises Act, S.A. 1995, c. F-17.1 [hereinafter 1995 Act] typifies the disclosure format. See s.4 and Regulation 240/95 for the disclosure requirements.
\textsuperscript{38} See S.A. 1995, c. F-17.1, s. 4(2).
\textsuperscript{39} See R.S.A. 1980, c. F-17, s. 34.
\textsuperscript{40} See R.S.A. 1980, c. F-17, s. 37. For further explanation, see Trebilcock & Sutin, supra note 2 at 3. The 1995 Act provides franchisees with a right of action for damages against the franchisor, every director of the franchisor at the time the prospectus was received, experts who provided opinions within the prospectus and against those who signed the certificate (see S.A. 1995, c. F-17.1, ss. 9 and 10). Rights of rescission are only available in cases where the franchisor fails to deliver the prospectus within the time restrictions (s. 13).
\textsuperscript{41} The 1980 Act typifies the registration format. See R.S.A. 1980, c. F-17, ss. 6–33 for provisions relating to registration.
documents provided by the franchisor. In addition, some jurisdictions require registration of the franchisor's sales force\textsuperscript{42} and biographical histories of members of management.\textsuperscript{43} The theory behind registration legislation is that disclosure, on its own, is insufficient to protect a franchisee; government assistance, therefore, is needed to determine the adequacy and fairness of franchise agreements. Yet, at the same time, government usually absolves itself of any liability in reviewing the franchise agreement and prospectus.\textsuperscript{44} Because of these constraints, registration systems are more costly to administer—fees for filing the prospectus\textsuperscript{45} are coupled with high transaction costs for legal and administrative preparatory work prior to registration. Eventually, these additional costs are borne by consumers as secondary costs passed down by the franchisee.\textsuperscript{46}

b.3 Relational

Unlike the above-mentioned forms of regulation, relational legislation attempts to circumscribe the franchisor's behaviour by prohibiting certain practices, the majority of which regulate the content of renewal, transfer and termination provisions in franchise agreements.\textsuperscript{47} Although the thrust of such legislation is to promote fairness, some commentators have criticized it as being, on the one hand, too inflexible, but on the other, too easily circumvented by franchisors. Imaginative franchisors often devise tactics to enhance their power over franchisees based on the wording of the legislation.\textsuperscript{48}

\begin{itemize}
\item \textsuperscript{42} See R.S.A. 1980, c. F-17, s. 20.
\item \textsuperscript{43} See R.S.A. 1980, c. F-17, Form 1, “Application For Registration of a Franchise”. For commentary, see Trebilcock & Sutin, supra note 2 at 4.
\item \textsuperscript{44} See, for example, R.S.A. 1980, c. F-17, ss. 32 and 40.
\item \textsuperscript{45} See regulations under R.S.A. 1980, c. F-17, s. 4, for example. Prior to the adoption of the \textit{Franchises Act}, S.A. 1995, c. F-17.1, the application fee for a franchise (or annual renewal) was $500, for registering a salesperson, $300.
\item \textsuperscript{46} The additional costs associated with registration systems have provided much of the impetus for recent reversals in a number of jurisdictions employing this form of legislation (Alberta is a noteworthy example). Both franchisors and franchisees have complained about the additional costs. See also Canadian Franchise Association statistics that estimate $40,000 initial costs for a franchisor to meet the old Alberta requirements.
\item \textsuperscript{47} See Trebilcock & Sutin, supra note 2 at 4. Other areas that may be subject to regulation include unfair practices such as statutory sanctions for misrepresentation of the level of success of a franchise (see R.S.A. 1980, c. F-17, s. 37 for example); procedures to ensure that any modifications to the franchise agreement are made known (see R.S.A. 1980, c. F-17, s. 17, for example); provisions respecting the use of non-competition clauses and promotion of free association among franchisees. See also Cal. Corp. Code § 31000. Pts. 3 & 4 (West 1980). Other jurisdictions employing some form of relational regulation of franchises include Arkansas, California, Michigan, New Jersey, Washington—see Davis, supra note 2 at 355.
\item \textsuperscript{48} See Trebilcock & Sutin, supra note 2 at 4.
\end{itemize}
Despite a number of years of experience with relational legislation, courts remain reluctant to depart from many of the traditional common law contract principles, with the result being that relationship laws are often ineffective. The arguments courts may use are based on choice of law, or centre on the fact that parties were of equal bargaining power and therefore there was no “community of interest” or that there was no franchise because the meaning of a franchisee was narrowly construed. Courts may also simply ignore legislation under the guise of allowing broader freedom of contractual rights. In one case, a court allowed the franchisor to terminate an agreement of indefinite duration despite a law requiring a franchisor to have good cause prior to terminating an agreement. This judicial timidity, as P.M. Pitegoff states, can be ascribed to the political nature of many of the franchise relationship laws; that is, they are often used as political solutions to legal problems.

49. See Modern Computer Systems v. Modern Banking Systems 871 F.2d 734 (8th Cir. 1989) (declining to apply the franchise relationship law of Minnesota, and relying on the parties’ choice of Nebraska law); Tele Save Merchandising v. Consumers Distributing 814 F.2d 1120 (6th Cir. 1987) (employing New Jersey law over the Ohio Business Opportunity Plans Act, and relying on the express contractual choice of the parties). In Canada, see Nike Infomatic, infra note 87.

50. Thus the relationship was not covered under the Franchise Practices Act (New Jersey)—see New Jersey Am. Inc. v. Allied Corp., Business Franchise Guide (CCH) p. 9395 (3rd Cir. 1989) (“good cause” termination requirement was inapplicable because there was no community of interest between the two parties to bring the relation within the definition of “franchise” in the Act); Colt Industries v. Fidelco Pump & Compressor Corp., Business Franchise Guide (CCH) p. 9095 (3rd Cir. 1988) (distributor was not found to be a franchisee because it failed to establish that it was subject to the whim, direction and control of a more powerful entity whose withdrawal from the relationship would “shock a court’s sense of equity”). “Community of interest” was also narrowly construed in Neptune TV Inc., 402 A.2d 595 and Cat Industries Inc. v. Fiskelles Pump & Compressor Corp., 844 F.2d 117 (3rd Cir. 1988).

51. Brawley Distribution Co. v. Polaris Industries, Business Franchising Guide (CCH) p. 9388 (D. Minn. 1989) (based on the definition of franchise under the Franchising Act (Minnesota)).

52. For example, see Zeigler Co. v. Rexnord Inc., 433 N.W.2d 8 (Wis. 1988). Here, a dealer rejected the onerous terms of renewal proposed by the supplier. Despite the existence of the Fair Dealership Law, the Wisconsin Supreme Court held that the dealer’s rejection was not saved by the legislation as the terms were “essential, reasonable and non-discriminatory” (at 12).

there is no consensus on the ideal franchise relationship law. On the contrary, these laws are surprisingly lacking in uniformity. One reason for this lack of uniformity is that decisions regarding these laws often reflect the outcome of political battles rather than a reasoned approach to franchising.

Too many State laws have arisen out of political power struggles; the statutes in many cases represent a legislative victory for one side or the other based on political strength, rather than being the considered outcome of an effort to produce efficient, fair and balanced law. Current law, in many instances, misses a fair balance between the interests of franchisor and franchisee and often ignores altogether the interests of consumers, other franchisees in the particular franchise system, or prospective franchisees in that system.54

b.4 Other Forms of Legal Relief

There are, in most jurisdictions, a number of statutes governing business relations in general, as well as common law principles that indirectly affect franchising. In Ontario the Business Practices Act, the Discriminatory Business Practices Act and the Unconscionable Transactions Relief Act, amongst others, may apply to franchise relations.55 Common law doctrines that may be applicable to franchising include decisions based on agency, restraint against trade, fiduciary relations and equitable doctrines such as good faith.59

54. Pitegoff, supra note 15 at 289.
56. A franchisor may be liable if it possesses sufficient control to be characterized as an agent. See for example, Billups v. Magness Const. Co., 391 A.2d 196 (Del. Sup. Ct. 1978); Kosters v. Seven-Up Co., 595 F.2d 347 (1979); in Canada, the case of Re Becker Milk Co. (1973), 1 O.R. (2d) 739 (Div. Ct.) is an example where Becker’s store operators were found to be employees, i.e. not independent contractors—but this finding relates mainly to a determination for purposes of the Employment Standards Act (R.S.O. 1990, c. E-14) and carries little weight as a precedent for substantive contractual remedies. See infra notes 123–29 and accompanying text.
57. See competition laws in the United States and Canada. Some of the areas impinging on franchising include exclusive grants to franchisees, restrictions on territory, tied selling, price fixing (s. 61 of the Competition Act, R.S.C. 1985, c. F-31), abuse of dominant position (s. 78) and control of supplies by franchisors (see s. 77). Some states prohibit covenants against competition, such as, for example, California.
58. See infra at notes 134–53 and accompanying text.
59. See infra at notes 107–22 and accompanying text.
2. United States Franchise Regulation—A Brief History

During the Depression of the 1930s, sales of automobiles declined. In order to counteract this trend, automobile manufacturers began terminating some of their franchisees in order to realize sunk investments. In many instances, the net effect was a complete breakdown of franchisor-franchisee relations. Wisconsin reacted to this in 1935 by passing a statute requiring all manufacturers and dealers in the state to be licensed. The Wisconsin Act proscribes a number of unfair acts of manufacturers including coercion related to delivery of vehicles and unreasonable cancelling of franchises.

After World War II, growth in the economy prompted automobile manufacturers to again use coercive tactics in order to force dealers to sell cars. As a result, Oklahoma passed its own manufacturer-dealer statute modelled after the Wisconsin Act. The most noteworthy difference in the Oklahoma Act was that it introduced the concept of a Motor Vehicle Commission, whose members are most often drawn from the ranks of automobile dealers, to administer the legislation. Many states have since followed Oklahoma’s example and appointed dealers to act as officials exercising statutory authority.

By 1956, although seventeen states had some form of automobile dealer-manufacturer legislation, attempts to pass similar statutes in other states were thwarted. The concern over a lack of national standards prompted Congress to pass the first federal franchise legislation, the Automobile Dealer's Day in Court Act.

In other industries, however, abuses continued to mount; in response, general legislation was promulgated in a number of states. The California Franchise Investment Law was the first general registration and disclosure law governing franchise sales. A number of other states soon followed and registration and disclosure laws were passed throughout the 1970s (Alberta also passed such a law in 1971). This evolved into some states drafting franchise relationship laws, some of which were enacted as part of a registration and disclosure scheme.

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60. Macaulay, supra note 27 at 27.
63. Macaulay, supra note 27 at 29ff.
64. 15 U.S.C. p. 1221-25 (West 1988). In 1964 Puerto Rico was the first U.S. jurisdiction to pass legislation protecting all types of local dealers.
66. Pitegoff, supra note 15 at 291. The influx of legislation during the 1970s did not carry over into the next decade. A number of states proposed franchise legislation during the 1980s but
In 1978, Congress enacted legislation protecting gas station franchisees. In addition, the Federal Trade Commission issued a rule on franchising requiring pre-sale disclosure. The FTC Rule became effective in 1979. Little else has occurred since then.

Among both franchisors and franchisees there was widespread disappointment with many of the legislative initiatives, related primarily to the lack of consistency from state to state. The National Conference of Commissioners on Uniform State Laws (NCCUSL) responded by creating a uniform state franchising law, but this has yet to be adopted in any state. The reason for this apathy, as Pitegoff argues, is that states without disclosure laws take comfort that the FTC Rule provides adequate coverage, while other states rely largely on either current laws relating to franchising or the common law.

In 1992 two franchising bills were proposed in the House of Representatives. The first, the Franchise Disclosure and Consumer Protection Act (FFDCPA), prohibited fraud, deception and misrepresentation, including any violation of the FTC Rule, and required revenues and costs accrued by franchisors to be disclosed. The Fair Franchise Practices Act (FFPA) prescribed legislative standards of conduct for good faith and due care, along with a limited fiduciary duty in certain circumstances. Both the FFDCPA and the FFPA died upon adjournment of the 102nd Congress.

the conservative agenda seems to have won over — for example, in 1989, Franchise Termination and Non-Renewal legislation was proposed but defeated in Kansas (H. B. 2244), Maryland (H. B. 1066), Massachusetts (H. B. 1317), South Dakota (H. B. 1355), and Tennessee (H. B. 319).

67. Petroleum Marketing Practices Act, 15 U.S.C. § 2801–06 (West 1988). The experience of gasoline dealers is one rife with abuses and extremely unfair practices on the part of the major oil manufacturers—see H. Brown, infra note 137 at 656–658. Brown is unconvinced that even with both government action and caselaw decided in franchisees' favour, any positive effect on oil companies' behaviour has occurred.


70. Pitegoff, supra note 15 at 292.

71. H.R. 5232. Proposed by Congressman LaFalce.

72. H.R. 5233. Also proposed by Congressman LaFalce.

73. For a more detailed analysis see L. Stadfeld, supra note 34; 10 Fran. L.J.
Currently three states have disclosure-only legislation,\(^{74}\) twelve have registration legislation\(^ {75}\) and eighteen have franchise relationship laws.\(^ {76,77}\) Seven of sixteen states (as well as Puerto Rico and the District of Columbia) incorporate franchise relationship laws as part of a franchise registration or disclosure law system.\(^ {78}\) These lines are continually being redrawn: the recent trend is away from state intervention, for reasons ranging from change in political climate, ineffectiveness of franchise registration schemes, and increased compliance costs associated with regulatory programs.\(^ {79}\)

3. **Franchise Legislation in Canada**

   a. **Alberta**

   a.1 **Introduction**

   Alberta introduced franchise legislation in 1970 and is still the only Canadian jurisdiction to have done so.\(^ {80}\) The original *Franchises Act*

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74. Hawaii, Michigan and Oregon. Although not technically registration states, Hawaii requires franchisors to file offering circulars at least seven days prior to the sale of a franchise and Michigan requires franchisors to file a notice before offering for sale or selling a franchise—see *Hawaii Franchise Investment Law* § 482E-3 and *Michigan Franchise Investment Law* § 445.1507a(1).


77. As noted in the above discussion, there are also special industry laws dealing with particular franchising areas such as motor vehicles, farm implements and machinery, motor fuel, beer and liquor industries. For up-to-date status of franchising laws and regulation in the United States, see G. Glickman, *Franchising* (New York: Matthew Bender, serial).


79. One of the major problems confronting franchisors is attempting to prepare agreements and disclosure documents in order to meet a profusion of different, sometimes conflicting, state regulatory schemes. The problem is now reduced somewhat with the adoption of the Uniform Franchise Offering Circular (UFOC), a common disclosure statement initiated by the Midwest Securities Administration Association. The UFOC allows a franchisor to prepare one basic offering circular for use in all member states, with simple revisions as may be required. It has been accepted by all member states. A further topic worth considering, unfortunately outside the scope of this paper, would be to determine what, if any, changes to the UFOC agreement are made for those U.S. franchises interested in expanding into Canada.

80. I will continue to refer to the original relational-format act as the *1980 Act* (R.S.A. 1980, c. F-17) and the recently adopted disclosure-only act as the *1995 Act* (S.A. 1995, c. F-17.1).
followed the California model closely, granting a government agency, in this case the Alberta Securities Commission, the power to administer the scheme. Initially the 1980 Act was a straightforward disclosure and registration type, requiring prospective franchisors to file a detailed prospectus with the Commission and providing potential franchisees with similar information. The Commission, however, became increasingly active in enforcing and promoting the 1980 Act, publishing eight administrative policies codifying a number of “good faith” provisions. Policy 4.2, for example, required a franchisor to show good cause prior to terminating a franchise and set out stringent procedures for franchisors to follow in cases of non-renewal.

In June of 1992 dramatic revisions were proposed to the 1980 Act under Bill 45 but these died after second reading. Then, in 1995, another complete revamping of the 1980 Act was proposed under Bill 33. The Bill came into force on November 1, 1995. For the 1995 Act, the main alteration from the 1980 Act is a change in the legislative scheme from registration to disclosure-only format. The prospectus required under the disclosure provisions falls essentially along the guidelines established by UFOC and is set out in detail under Regulation 240/95. Obviously, it is a large concession to franchisors, who have demanded changes to the Act for a number of years. It also lowers the protection afforded franchisees in Alberta, although the wider definitions of “misrepresentation” and “material fact” found in s. 1 of the 1995 Act may equalize this disparity.

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81. One noteworthy provision adopted without discussion from the California legislation is section 2 which exempts from the provisions of the Act franchisors with a net worth over $5 million that have licensed at least 25 franchises in the past five years. One wonders when size became equated with honesty in legislative circles.
82. Administrative Policies 4.1–4.8.
84. Bill 45 included changes to the definition of “franchise” and a tightening of the definition of “franchise fee” to prevent franchisors from simply dispensing with a fee in order to circumvent the Act. The Commission, in its background paper to Bill 45, alluded to this problem by pointing out that franchisors would describe payments made by the franchisee as “profit sharing” or would add extraordinary mark-ups to the price of goods sold to the franchisee, in order to deliberately avoid the Act. The proposed Bill hoped to catch virtually all situations where a continuing financial interest—as opposed to a franchise fee—existed between parties. Many of these concepts are incorporated in the draft Ontario Bill (see discussion at infra, notes 97–101.)
85. The Bill was a private member’s bill advanced by Mr. Doerksen.
86. See supra, note 37.
a.2 Scope of the Franchises Act

Although the intent of the Act was to broadly regulate franchising, its purview has been judicially limited. In Nike Infomatic Systems Ltd. v. Avac Systems Ltd. the British Columbia Supreme Court was faced with a question of which law to apply to a contract between a franchisor in British Columbia and a franchisee in Alberta. As a secondary issue, the court examined what effects the Act had on parties to an agreement. The Court found that the primary purpose of the Act is regulating and controlling franchises; the Act contains no express language for declaring contracts void, but simply provides for certain explicit remedies. Therefore, the court found, in obiter, that the Nike Infomatic franchise agreement was not void for contravening provisions of the Act but was simply subject to statutory penalties. Apart from the fact that the statement was obiter, it could be dismissed as an attempt by one court to extend its reach for businesses centred in its own jurisdiction. However, in Colour Your World Inc. v. Avery (Robert F.) Holdings Ltd., the Alberta Court of Queen’s Bench decided along the same lines. The franchisee argued that since the franchisor failed to provide it with the required Statement of Material Facts, the agreement was void. Matheson J. held the contract was valid and binding even though a formal breach of the Act occurred. It was further held that since the Act does not expressly state that unlawful contracts are void, it is not within the power of the court to rescind the franchise agreement.

It is worth highlighting a few points from these decisions. First, as between two contracting parties to a franchise in Alberta, the common law rights of action on contracts (for example, suing for rescission or for damages) still exist. Franchisees should be especially aware that they cannot rely on the Act to protect them once an agreement is executed. Secondly, the laws of other jurisdictions, as may be specified in the franchise agreement, or based on residency, may govern, thus allowing franchisors to circumvent some portions of the Alberta scheme. In the Nike Infomatic case, it was possible for Nike Infomatic to avoid complying with the Act because of its ties to British Columbia.

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87. (1979), 105 D.L.R. (3d) 455 (B.C.S.C.). In this case, the franchisor was based in B.C. whereas the franchisee was based in Alberta.
89. The only provision in the 1980 Act allowing for remedies of rescission was found in section 37. As Avery was not the franchisee, there could be no application of s. 37: “Rescission is only available if parties to a contract can be put back in their original position. That is not something that can be done more than five years after entering into the franchise agreement” (at 189).
90. The implications of this decision may make it easier for franchisors to register in other jurisdictions and avoid, in some circumstances, the provisions of the Act.
a.3 The Future of Alberta's Franchise Legislation

In its background report prepared in advance of proposed revisions to the *Franchises Act* (Bill 45), the Alberta Securities Commission noted that franchisors were concerned that the registration process was too cumbersome and expensive. Like their counterparts in the United States, franchisors characterized the Act as a minefield, failing to protect franchisors against the most flagrant abuses of dishonest franchisees and causing increased litigation. On the other hand, franchisees expressed a desire for more simplified, and less costly, franchise agreements and disclosure documents, believing that the standard franchise agreement was overly complex because of the requirements of the Act. Franchisees continued to express the desire to be treated fairly in the franchise relationship. It remains to be seen whether the 1995 Act will alleviate any of these concerns.

Perhaps most telling to even a casual observer is the absence of franchising legislation in any other Canadian jurisdiction. A few forays have been made in some provinces, but they have not been successful. The next section is a brief overview of attempts made in Ontario, Manitoba and British Columbia.

b. Franchise Regulation in Other Provinces

b.1 Ontario

The Government of Ontario undertook a comprehensive analysis of franchising culminating in the publication of the Grange Report in 1971. The Report outlined a number of problems it felt were endemic to franchising. First, it found that an inequality of bargaining power between franchisor and franchisee inevitably produces inequitable contracts, “even where honest attempts have been made to redress the balance between the parties.” Second was the often unfettered right of franchisors to terminate franchise agreements. The Report acknowledged the need to curtail this discretion but recognized that it must be balanced against the need for franchisors to quickly remove incompetent franchisees.

The recommendations adopted in the Report were quite far-ranging. One proposal considered forming a Franchise Bureau with a Franchise Registrar while another advocated “fair dealing” in franchising by mandating certain terms and prohibiting specific practices between

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91. Zaid, supra note 13 at 16.
93. Grange Report, supra note 8 at 39.
94. Grange Report, Recommendation #1.
franchising parties.95 The Report recommended adopting a registration and disclosure system similar to that employed in Alberta at the time, listing an extensive number of items for inclusion in a prospectus, using the California and Alberta requirements as benchmarks.96 But the Grange Report was never adopted into legislation.

There have been other legislative attempts since 1971 but none has met with any success. In 1987, the government announced that legislation regulating franchises would be introduced during 1987, but the impetus quickly died. In 1994 Bill 182, entitled the Franchises Act, 1994, was introduced privately by the MPP from Windsor-Riverside, Jim Wiseman.97 Bill 182 followed the original Alberta regulatory scheme by requiring, for example, a statement of material facts,98 a prospectus99 and the registration of salespersons.100 It also included substantive obligations for both franchisor and franchisee by mandating standards of good faith and commercial reasonableness in all franchising activities.101 Given the change in government in 1995, this Bill will not become law. Nevertheless, there is a chance that future legislative initiatives may rely on it as background material for understanding some of the issues in franchising law.

b.2 Manitoba

In 1992 a private member's bill was introduced in the Manitoba legislature calling for franchise legislation.102 The bill required franchisors to give a statement of material facts to all prospective franchisees,103 file a prospectus with the franchising director,104 as well as register all sales personnel.105 The bill was ultimately defeated prior to second reading.
b.3 British Columbia

The British Columbia Law Reform Commission recently completed preliminary research on franchising, but has not yet released a working paper. Preliminary evidence is that the commission will propose some form of legislation modelled on the disclosure-only format, tied to recommendations for minimum standards of conduct.\(^\text{106}\)

Legislative remedies addressing some of the problems surrounding franchising in Canada seem to have stalled. Governments are not yet convinced that there is a need for legislation directed specifically at franchises. It is often argued that common law remedies are sophisticated enough to cope with all the vagaries of commercial franchising practice and adequately ensure fairness and reasonableness between parties to a franchising agreement. The next section examines some of the common law doctrines applicable to franchising.

II. Common Law, Self Regulation and Remedying Franchise Disputes

1. Franchising and the Common Law

Because franchising shares many of the features of other commercial relations, the common law remedies that have developed over time are useful in structuring a framework for analyzing and resolving franchise disputes. This section is a review of some of the more common legal doctrines that have been applied in a franchising context.

a. Implied Terms of Good Faith

Unlike the United States, where states adopting the Uniform Commercial Code (UCC) have imposed an implied duty of good faith and fair dealing in contracts,\(^\text{107}\) there is much debate whether concepts of good faith and fair dealing in contracts exist in Canada. There are conflicting lines of authority about this.

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\(^{106}\) Zaid, \textit{supra} note 13 at 23.

\(^{107}\) Section 1-203 of the Uniform Commercial Code, for example, provides that "every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement". Articles 1 and 2 define good faith slightly differently, but it does include, in certain instances, "reasonable commercial standards of fair dealing in the trade". Franchisees in the U.S. have used this implied duty to ensure that a franchisor's discretion is somewhat tempered. A worthwhile definition of what "good faith" might mean in a franchising context is "curbing franchisors' unlimited discretion."
The case of Greenberg v. Meffert,108 is instructive. In a contract between a real estate company and a sales agent, a clause was included that made commissions after termination payable at the discretion of the real estate company. Although the case did not involve franchising, it stands for the proposition that in some cases a court may interfere with the exercise of discretion conferred by contract. The Court of Appeal held that decisions made by a company should be controlled by objective standards: “the exercise of the discretion ... is subject to a requirement of honesty and good faith.”109 This doctrine was extended into a franchising context in McKinlay Motors Ltd. v. Honda Canada Inc.110 There, a Honda manager did not allocate a reasonable share of cars to McKinlay Motors, intending to force the dealer to terminate. The court stated:

I find that Honda acted in bad faith under the agreement. It is obviously an implied term of any such agreement that the parties act toward each other in their business dealings in good faith.111

In contrast, the British Columbia Court of Appeal in Estate-Gard Services of Can. Ltd. v. Loewen Mgmt. Corp.112 reached the opposite conclusion. The court relied on the express provision in the agreement making Estate-Gard an independent contractor. The court was unwilling to imply into a franchise contract a term as “vague as good faith and confidence”.113

This lack of unanimity is explained to a large extent by the actions of the individual franchisor or the franchisee, although it is often not a factor alluded to by courts. In McKinlay, it was evident that Honda’s actions were egregious enough to warrant intervention by the court. In Yamaha Can. Music Ltd. v. MacDonald & Oryall Ltd.,114 a case involving the notice period for an exclusive distributorship, the court indicated that certain factors may help raise the notion of good faith. The court stressed

109. Ibid. at 761. See also W.H. Violette Ltd. and Violette Motors v. Ford (1980), 31 N.B.R. (2d) 394, appeal dismissed (1981), 34 N.B.R. (2d) 238 (C.A.) (“dealings between parties must be executed and regulated in a fair and equitable manner”); Peters Auto Sales v. Chrysler (1990), 63 Man. R. (2d) 295 (Q.B.) (court recognized that there is a general duty of good faith but found that the facts did not give rise to a breach).
110. (1989), 46 B.L.R. 62 (Nfld. S.C.T.D.). See also Shar-Cat Corp. v. IBM Canada Ltd. (1990), 66 Man. R. (2d) 161 (Q.B.) (implied term that IBM give reasonable notice of its intention to change practice of submitting rebate claims on behalf of franchisee. Sixty days notice was not fair nor in accord with the principles of natural justice).
111. Ibid. at 80.
113. Ibid. at 372.
the importance of the length and type of relation, the extent of the sales force and franchisee network, the importance of an exclusive distributorship to the distributor, the method of acquiring inventory and the time needed for the distributor to acquire any replacement products. In this instance the court was hesitant to apply a general conception of good faith without the presence of some unreasonable or dishonest practice related to these factors.

Anglo-Canadian courts are more comfortable imputing principles of good faith in the negotiation phase of a contract. In a franchising context, this was applied in Avos Holdings Ltd. v. American Motors (Canada) Inc.\(^ {117}\) During the negotiations to establish an AMC dealership in Kelowna, British Columbia, Avos was informed by the company that the only other AMC dealership in Kelowna would be terminated. Avos acted on this advice. After a number of attempts to have AMC fulfill its promise without success, Avos was forced to close his dealership due to poor sales and he sued AMC. The court held that the representations of exclusivity made by the franchisor induced the franchisee to enter into the contract and formed an independent contract. This is an example of good faith in another guise.\(^ {118,119}\)

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115. Ibid. at 367 (citing Western Equip. Ltd. v. A.W. Chesterton Co. (1983), 46 B.C.L.R. 64 (S.C.)).
118. For another case where a franchise or other long term contractual relationship has given rise to a finding of a collateral warranty due to pre-contractual discussions, see Atlas Supply Co. of Canada v. Yarmouth Equipment Ltd. (1990), 30 C.P.R. (3d) 380 (N.S.S.C.) af'd (1991), 37 C.P.R. (3d) 38 (N.S.C.A.).
119. The conceptual and practical difficulties present in establishing independent warranties or collateral contracts have been well documented. It might have been a much greater benefit to the body of contract law if these cases had been seen as examples of bad faith worthy of the court's protection. See as examples amongst many others, Mendelssohn v. Normand Ltd., [1970] 1 Q.B. 177; Tilden Rent-A-Car Co. v. Clendenning (1978), 83 D.L.R. (3d) 400 (Ont. C.A.); and Bank of Montreal v. Murphy, [1986] 6 W.W.R. 610 (B.C.C.A.). See, as examples where collateral contracts have not been created, Hawrish v. Bank of Montreal (1969), 2 D.L.R. (3d) 600 (S.C.C.); Carman Construction Ltd. v. Canadian Pacific Ry. Co. (1982), 136 D.L.R. (3d) 193 (S.C.C.). For commentary on the wild and varied world of contractual misrepresentations and collateral statements, see for example S.M. Waddams, The Law of Contracts, 3d ed. (Toronto: Canada Law Book, 1993) at 225–29; K.W. Wedderburn, “Collateral Contracts” (1959) Camb. L.J. 58 at 61–64; for a debunking of classical contract theory which discounts the possibility of parties ever reaching an epiphany or “meeting of the minds” see I. Macneil, whose body of work in the area of relational contracts is staggering—for example “Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational
Good faith is also manifest in cases where courts imply reasonable periods of notice prior to termination. Both *Hillis Oil & Sales Ltd. v. Wynn's Canada Ltd.*\(^{120}\) and *Dart & Oliphant Holdings Ltd. v. Yamaha Motor Canada Ltd.*\(^{121}\) are examples where a notice period for termination was not expressly stated or was ambiguous.\(^{122}\) Both courts found it fair to incorporate some reasonable period of notice as indicating good faith. To a large extent, these cases are dependent on the lack of an express notice period in the contract. Obviously it is much simpler for courts to imply terms of this nature when they are not faced with a contractual provision dealing expressly with proper notice for termination. So far, courts have not been willing to imply good faith provisions in contracts where unreasonably short termination periods are expressly stated. In Part IV, the argument will be made that imputing reasonable notice periods does not adequately deal with the concerns of both franchisor and franchisee in terminating a relationship: it not only ignores the need, in some situations, to react quickly to fraudulent or other kinds of detrimental behaviour, but it also fails to acknowledge that reasonable notice cannot be an adequate measure of damages in circumstances where interdependency and coexistence have come to define the relation. This attempt by courts to use good faith to render more equitable results is, therefore, largely superficial.

b. *The Franchisor as Employer*

The franchisor/franchisee relationship has been characterized as a master-servant relationship in circumstances where the franchisor exerts extensive control over the franchisee. In two decisions in Canada “store managers” were held to be employees, bringing the franchisors under applicable labour standards.\(^{123}\) The National Labour Board in the United States has also found drivers operating under franchising lease arrangements to be employees, rejecting the usual criterion of independence.\(^{124}\)

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121. (1977), 10 A.R. 366 (S.C.T.D.). Note that there was no written agreement between the parties in this case.
122. See *Hillis*, supra note 121 at 655.
The Ontario Labour Relations Board has advanced this concept further, finding in one case a franchisor to be a "related employer" for determining collective bargaining rights. There is implied in all these decisions a determination that the extent to which a franchisor controls a franchisee may create unintended legal consequences. And the availability of legislative tools for employees, in Ontario particularly, could be used in the future to promote a more equitable balance between franchisor and franchisee.

When courts sometimes find that franchisees are employees, they insinuate that an association deeper than a simple commercial relationship exists between franchisees and franchisors—or at the very least that there is more than a simple contractual relation between independent businesses. But it is difficult to attach precedential weight to these decisions because they remain isolated and limited to specific employment and labour law situations. As will be discussed, extending concepts of employment law into the franchising field, as a way of expanding equitable principles, remains unsuccessful.

c. The Franchisee as Agent

Standard franchise agreements expressly state that the parties are not agents of each other. In a few cases, courts have delved beyond this express statement and found a relationship of agency because the franchisor and franchisee were so inextricably linked to each other. For example, in three separate cases involving the Arthur Murray Dance School, the California District Court found that the dance school exerted control beyond that generally found in franchise relations and was therefore a

126. An interesting example is cited by R. Davis, supra note 2 at 360. According to Davis, some U.S. federal agencies now take the position that franchisees and their employees are employees of the franchisor under a number of regulatory laws dealing with wages, working hours and employment discrimination. This position is not widely adhered to and is being strenuously opposed by both franchisors and franchisees. Nevertheless, it indicates some flexibility in the approach government is taking in characterizing franchise relationships, and that it may choose to fight its battles on a number of different fronts if need be (especially if federal attempts to regulate franchising directly are failing—see supra at notes 70–74 and accompanying text).
127. See ss. 1(4) and 7 of the Labour Relations Act, R.S.O. 1990, c. L.2. For an analysis of the interplay between franchising and these provisions, see Roberts, infra note 172.
128. See commentary on fiduciaries, infra at notes 134–53 and accompanying text.
Franchising in the Shadow of Contract Law

principal, liable for the acts of its agent, the individual franchisees. In each case, individuals enlisted for dance lessons that were not honoured because the franchisees were insolvent. The dancers then turned to Arthur Murray for relief. In all three instances, the court found that the lack of autonomy granted to the franchisee was sufficient to create a legal agency between the franchisees and Arthur Murray. In effect, because Arthur Murray controlled the selection of the franchise location, required each franchisee to report gross receipts of operating revenue and pay a percentage to it, and oversaw much of the franchisee’s general operating procedure, it was liable.

How did this situation give rise to a finding of agency, where others have not? No satisfactory answer can be found on analytical grounds.

Today’s franchise agreements are equally, if not more, onerous in the methods used to control franchisees. But the judiciary is reluctant to import the obligations and responsibilities from agency into franchising. While many aspects of a franchise relation mirror those of agency, there are many other components unique to franchises that bear no resemblance to agency. The Arthur Murray cases are examples where the courts

132. For example, a sample from a standard, 50 page, franchise agreement:

The Franchisee acknowledges that, in order to foster and preserve such goodwill, the Franchisee must operate the Centre in a manner that is consistent with the Franchise Method and Franchisor must, therefore, exercise control over the operation of every centre. Therefore, the Franchisee agrees to operate the Centre strictly in accordance with the Franchise Method as prescribed in the training courses, the Manual or otherwise.

In order that the Franchisor may be assured that the Franchisee is fully and faithfully carrying out all of the terms and the intent of this Agreement, the Franchisee shall allow representatives of the Franchisor at all reasonable times with or without prior notice:

(c) to inspect the Franchisee’s place of business and the Franchisee’s inventory;
(d) to examine the Franchisee’s personal knowledge of the Franchise Method, the Manual and other products relating to the Franchise Method . . .

Included as part of this franchise arrangement was a 200 page manual describing the various techniques and procedures in the Franchise Method.
133. See Fels, supra note 7. Fels suggests that franchising, while dependent on the mutuality of the relationship between franchisor and franchisee, like an agency relationship, is also akin to any contractual relationship between two independent parties. Each party bears certain risks, is entitled to certain profits and, in the end, works as an individual entity in search of a mutually beneficial goal.

As a parenthetical note, economic analysis in franchising often proceeds on the assumption that there is much overlap between concepts of agency and franchises. Since the
struggled to mould traditional contractual concepts to fashion remedies in a situation that begged for relief. They are not, however, precedents for establishing a normative standard of agency in franchising relations.

d. **Franchising as a Fiduciary Relationship**

d.1 **Fiduciary Law in General**

The law relating to fiduciaries is expanding. In a complex world an increasing number of interrelations have fiduciary characteristics, and courts are slowly recognizing this. What is now construed as a fiduciary obligation is not based simply on the form of the relation but also accounts for the idiosyncratic nature of each situation; sometimes a relationship may be described as fiduciary for some purposes, but not for others.

franchisor controls much of the franchisee’s discretionary authority, the economic model of agency is useful descriptively for analyzing franchisees’ behaviour. See P.H. Rubin, “The Theory of the Firm and the Structure of the Franchise Contract” (1978) 21 J. L. & Econ. 223 at 225; Makar, *supra* note 2 at note 19.


135. Originally trustees were the only fiduciaries, so-called. Over time, courts recognized partnerships, agency and solicitor-client relationships as examples of fiduciaries. Anglo-American courts seem to have an aversion to fixing the definition of fiduciary lest it create a closed category. However, there may be differences between institutional fiduciaries and fact-based fiduciaries, so-called. See Gautreau, *ibid.* at 2 and Smith, *ibid.*

136. J.R.M. Gautreau goes beyond even this. He argues that the concept of fiduciary duty is relevant only in terms of remedy and that there is no difference in substance between fiduciary duties and other duties, other than the degree of power, reliance and vulnerability—*ibid.* at 17ff.

137. From Justice La Forest in *McInerney v. MacDonald* (1992), 93 D.L.R. (4th) 415 at 427 (S.C.C.); see also *Two Brothers Kingston Limited v. Zakos* (1985), 28 D.L.R. (4th) 541 (Ont. H.C.J.) aff’d (1988), 27 C.C.L.I. xxxiv (C.A.). Although the notion of examining the substance of a relationship in order to determine whether it is a fiduciary one has some conceptual attractiveness, it has not been applied to some of the more traditional, accepted, fiduciary relationships. One could question, for example, whether all lawyer-client or doctor-patient relationships are necessarily fiduciary. (For example, is a lawyer a fiduciary when asked to
Fiduciary obligations typically flow in one direction, creating a source of trust in the entrustor by relying on another’s expertise. As stated by Frankel:

... fiduciary relations are designed not to satisfy both parties but only the entrustor. ... [A]n entrustor does not owe the fiduciary anything by virtue of the relation except in accord with agreed-upon terms or legally fixed status duties. Therefore, in a fiduciary relationship, the entrustor is free from domination by the fiduciary, although he may still be coerced in a parallel status relation. ... [T]he entrustor’s vulnerability to abuse of power does not result from an initial inequality of bargaining power. ... The relation may expose the entrustor to risk even if he is sophisticated, informed and able to bargain effectively.

At the heart of a fiduciary relationship rests a moral imperative; loyalty and honour, rather than laws or contracts, are said to govern the fiduciary’s behaviour. Courts have, with mixed success, recognized this moral aspect to fiduciary obligations, placing much emphasis on the altruistic and voluntariness of the relation. Legally, the relationship does not require trust in a subjective sense between parties, but simply the fulfilling of obligations giving rise to a legal trust. It is the unidirectional aspect of fiduciary obligations that is often cited as a reason for courts not finding a fiduciary relation in franchising situations.

d.2 Fiduciaries in a Franchising Context

The sea of Canadian jurisprudence parted once to permit a fiduciary argument to be made by a franchisee, but the waters returned on appeal. In *Jirna Ltd. v. Mister Donut of Canada Ltd.*, the franchise agreement

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138. Although see Austin, *infra* note 150.
139. Frankel, *supra* note 134 at 801 and 810. The last part of this passage was also quoted by McLachlin J. in *Norberg, supra* note 134 at 491.
140. See Gautreau, *supra* note 134 at 6. He describes situations where the concept of fiduciary has “drifted from its conceptual moorings” and been confused with unjust enrichment, for example. This confusion, or deliberate legal fiction, is unnecessary in Canada because our concepts of both unjust enrichment and constructive trust are independent of the concept of fiduciary obligation (see, for example, *Petkus v. Becker*, [1980] 2 S.C.R. 834).
141. See T. Frankel, *supra* note 134 at 829ff.
142. Gautreau, *supra* note 134 at 9. “Subjective trust” is taken to mean some kind of implicit faith or confidence. For example, a dentist may not necessarily inspire confidence in his or her patient, but the relation is still fiduciary.
constrained the franchisee in its choice of suppliers and the prices it paid. A dispute arose when the franchisee discovered that the franchisor was receiving kickbacks on each order the franchisee placed with the supplier. At trial, the Ontario High Court of Justice held that the special closeness in this case created a fiduciary relationship; that is, a constructive trust had formed that necessitated the franchisor to account for all its earnings.

The decision was overturned on appeal. The Court of Appeal, affirmed by the Supreme Court of Canada, found that the situation did not have the necessary characteristics of a fiduciary relationship. It concluded that the franchisee was adequately represented by sophisticated business and legal counsel and, in any event, the profits were not secret. There was nothing exceptional to take this case outside normal franchise relations. Although the possibility of finding fiduciary obligations in a future franchise relation was left open, no Canadian franchisee has, as yet, successfully claimed that a fiduciary relationship exists with a franchisor.

This trend is consistent with experience in the United States and Australia where courts are disinclined to find fiduciary duties in franchise relations. In Hospital Products International Pty. Ltd. v. United States Surgical Corporation, the franchisee embarked on a premeditated and sophisticated form of piracy by taking hospital equipment provided by the franchisor, “reverse engineering” it and using the information gained to its profit. USSC sought damages for breach of contract and also for an accounting of profits from HPI, contending that HPI was a fiduciary. At trial, USSC won on both counts. On appeal though, the Australian High Court refused to find a fiduciary relationship. The case mirrors in the separate findings reached by both the trial and appeal courts, but it is a neat rejoinder to criticisms that allowing fiduciary duties to govern franchising situations will unduly profit franchisees. The same line of judicial reasoning that is used most often to

144. Brooke J.A. noted that the question of whether the profits were secret or not was not at issue on appeal, but stated that he would have decided opposite to the trial judge, ibid. (C.A.) cited to O.R. at 254.
145. Ibid. (C.A.) at 257 (cited to O.R.): “... in some cases... the Court... should find that the relationship... is something other than what they themselves have provided for...”
146. See, for example, Premier Wine & Spirits v. E. & J. Gallo Winery, 846 F.2d 537 at 540ff (9th Cir. 1988); Power Motive Corp. v. Mannesmann Demag Corp., 617 F. Supp. 1048 at 1051 (D. Colo. 1985); Boat & Motor Mart v. Sea Ray Boats, Inc., 825 F.2d 1285 at 1292 (9th Cir. 1987). The law on fiduciaries is different in the United States, however, and caution must be advised in trying to draw from it universal concepts that would apply in Canada.
148. See Gibbs C.J. ibid., at 596–98.
restrict franchisee’s remedies—that a fiduciary relation is special and not part of normal commercial practice—was used to adversely affect the franchisor.

The recent expansion of the law of fiduciary obligations in Canada and Australia may have raised expectations that, in the franchising field at least, the legacy established by the trial decisions in the Jirna and Hospital Products cases could be restored. But the case of Riverside Cycle Ltd. v. Hazen suggests that the sea may never be parted again; that improper motivations of a party are unimportant in determining the character of a commercial relation and that even where deliberate predation occurs, commercial franchise relations will not be fiduciary ones. In fact, the court held that there is no implicit fiduciary duty in a dealer-distributor type of commercial relation. A dealer may sue for damages if a breach of the agreement occurs, but is not entitled to equitable remedies. Strangely enough, there was no mention of either LAC Minerals or the Australian United Dominion case in the Riverside case.

Are we left with any scope at all for finding fiduciary relationships in franchises? In those rare instances where one of the parties steps beyond

149. See Hodgkinson v. Simms and LAC Minerals v. International Corona Resources Ltd., supra note 134. The Supreme Court set out the test for determining the existence of a fiduciary relationship as follows: (i) a fiduciary has some scope for exercise of some discretion or power; (ii) the fiduciary can unilaterally exercise that power or discretion so as to affect the beneficiary’s legal or practical interests; (iii) the beneficiary is vulnerable or at the mercy of the fiduciary in respect of the subject. The Court in LAC stated that a fiduciary obligation will seldom be present in dealings of experienced businessmen of similar bargaining strength acting at arm’s length. In other words, any vulnerability that may arise between business people can be prevented through more prudent exercise of bargaining power and any wrongful exercise of such power by the fiduciary can be addressed through an award of damages, rather than equitable relief. In Hodgkinson, La Forest J., speaking on behalf of the majority holding in the case, stated that the vulnerability arose out of the reasonable expectations of the parties entering into a relationship, which depend on matters such as trust, confidence, complexity of subject matter and community or industry standards (at 412). Smith, supra note 134 makes the point that after Hodgkinson the test for determining a fiduciary relationship is somewhat murkier. However, there is little to offer hope for franchisees in either of these cases (see infra). Gautreau, supra note 134 at 18, points out that the LAC case is another example where the need for a “fiduciary remedy” inclined the court to label the relationship as fiduciary when it arguably was not. Gautreau suggests a similar result, but more analytically pure, could have been established through the doctrine of unjust enrichment. A similar argument could be made of the Jirna case, supra note 143.

150. See United Dominions Corporation Limited v. Brian Pty. Ltd. (1985), 60 A.L.R. 741 (Aus. H.C.). Although this case did not deal with franchising per se, it developed the argument for fiduciary obligations in a commercial setting. See also R.P. Austin, supra note 134.


152. Riverside, ibid. at 188–89. As Krindle, J. stated, when confronted with the argument that the court should rewrite the termination clause and replace it with a notice period of one year: “for the life of me, I can’t follow the leap in logic inherent in this position.” (at 188).
all reasonable boundaries, the answer may be positive. That said, it will have to be a gross abuse of power; something that most franchisors, at even the most basic level of sophistication, are able to circumvent by careful drafting of the agreement.153

e. **Unconscionability and Inequality of Bargaining Power**

In some circumstances the remedy of unconscionability may be applied to franchises. Like the remedies described previously, unconscionability is fraught with analytical difficulties, exacerbated when brought into a relational or franchising context.154 Although unconscionability is sometimes broadly defined for inequality of bargaining power, good faith or fair and equitable dealing,155 the resulting analytical messiness means none of these situations is determinative—there may be unconscionability elsewhere.156 Where the franchise agreement is little more than a disguised attempt to avoid employment standards provisions, for example, there is a natural inclination to find unconscionability as well.157

Franchise relationship laws attempt to redress problems of unconscionability and inequality of bargaining power between franchisor and

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153. See Gautreau, *supra* note 134 at 10-14 and my comments at Part IV.
155. See *ibid.* and section on Good Faith *supra* notes 107–122 and accompanying text.
157. See *Head v. Intertan Canada Ltd.* (1991), 5 O.R. (3d) 192 (Gen. Div.). Farley J. stated, in *obiter*, that in franchise agreements, where provisions exist to terminate without cause, a court should look at the longevity of the agreement, the amount of the franchisee’s investment, etc., in order to determine whether the existence of such a clause is unconscionable. The decision is, to my mind, very progressive.
franchisee.\textsuperscript{158} There is evidence of their success in controlling inequality and limiting some of the unscrupulous behaviour of franchisors,\textsuperscript{159} which may even spill over into jurisdictions that do not have such laws.\textsuperscript{160} However, as franchisees become more sophisticated, forceful and discriminating in their choice of franchisors,\textsuperscript{161} the necessity of these laws has been questioned. Critics of relational laws point to evidence showing a reduction in the number of franchises terminated and the higher rates of renewal of franchises compared to previous decades. This is apparently sufficient, in their minds, to show greater franchisee satisfaction overall.\textsuperscript{162} Whether this position is just a reflection of the current economic situation is open to question.\textsuperscript{163}

e.1 \textit{Self-Regulation of Franchises}

An alternative to the public creation or development of formal legal mechanisms specifically for franchises is to create self-regulatory bodies through franchise associations. There are presently a number of independent franchisee associations in Canada that are self-supporting; they are financed by membership fees from member franchisees. The largest of these organizations may be managed by professionals and have staff executive directors, legal counsel and other professionals.

\begin{footnotesize}
\begin{enumerate}
\item [158.] See Pitegoff, \textit{supra} note 15 at 314.
\item [159.] Ibid.
\item [160.] Because most larger franchises follow the UFOC guidelines and have standardized agreements. A number of questions that cannot be answered in this paper arise however: What about the smaller franchises that do not operate in legislated jurisdictions? This is especially pertinent in Canada, where a franchisor is not likely, unless intending to expand into Alberta or parts of the U.S., to consider providing the franchisee with some of the inequality-reducing measures. See also the query raised at note 79, \textit{supra}.
\item [161.] Pitegoff, \textit{supra} note 15. He cites the examples of Computerland Corp., Burger King and AAMCO. In the Computerland situation, pressures from franchisees led to changes in the management structure of the franchisor, and a reduction in the royalties paid by franchisees to the franchisor. Similarly, the franchisees of Burger King participated in the buyout in 1988 of Pilsbury (Burger King’s parent). AAMCO reduced its franchise fees by 40% as a result of franchisee pressure.
\item [162.] See for example, Pitegoff, \textit{ibid}. at 314–16. Makar, \textit{supra} note 2 at note 113 cites the following statistics for U.S. terminations in 1984: Of 2,649 franchisor initiated terminations, 1419 were for nonpayment of royalties or other finances, 270 for franchisee’s failing to comply with quality control standards and 960 were unspecified. (these statistics were provided by the U.S. Dept. of Commerce, \textit{Franchising in the Economy}, 1984–86 13 (January, 1986). The 1990 statistics released in “Franchising in the Canadian Economy”, \textit{supra} note 20 indicate that in Canada, 275 terminations were initiated by the franchisor, 51% for non-payment, 23% for quality control violations and 26% for other reasons; 234 terminations were initiated by the franchisee (at 37).
\item [163.] See Sotos, \textit{supra} note 32.
\end{enumerate}
\end{footnotesize}
So far, these associations have had relatively little impact on franchisor behaviour. For instance, regulating franchising is not on the agenda of franchisee associations. Legislation, both statutory or internally created, is typically viewed as cumbersome and expensive by the majority of these associations. In any event, of more concern to members is keeping abreast of business developments, co-operating on advertising plans, planning trade-shows and amending standard form franchise agreements.

Another potential supervisory body is the Canadian Franchise Association [CFA], which could also assume a governing role by taking steps to eliminate unfair and fraudulent behaviour in the industry. There are many self-governance models that the CFA could use for guidance. For starters, the CFA could assist in setting membership admission and renewal criteria, establishing a complaints review mechanism and mandating minimum levels of disclosure and standards of information in a similar vein to statutory disclosure and registration schemes found elsewhere. But self-regulation by the CFA could go much further. Certain franchisor practices could be proscribed, thus protecting the public from excessive abuses while pre-empting legislative encroachment on what is seen as franchising industry territory.

Unfortunately, because the CFA has no membership requirements, most franchisors do not join. It will, therefore, be necessary to engage the assistance of the large number of powerful franchisors to give the association some clout. Even if this hurdle were overcome, it remains unclear whether self-regulation of businesses or business groups is effective.

The discussion in the first two parts of this paper attempted to show how neither government regulation nor the application of common law remedies has been successful in addressing the most serious concerns of franchisees. It is also unclear, at this stage, whether self-regulation of

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164. Although arguably, the franchisee associations have significantly improved their standing in the last few years. An interesting avenue of exploration would be to compare the impact of unions on labour and franchise relationships with that of franchisee associations.

165. For a more detailed description of these activities, see Zaid, supra note 13 at 19-20.

166. See for example, Sotos, supra note 32 at 35.

167. See ibid. at 34-35.

168. Ibid.

franchising will take hold in the commercial climate of today. How franchise relationships may need to be re-characterized in order to bring some sense to this rapidly exploding form of corporate grouping is the focus of the remaining two parts of the paper.

III. Long Term Relations: Creating a New Franchise Model

1. Introduction

Almost since the beginning of franchising, most commentators have described the franchise relationship as contractual. Franchisees are viewed as independent businesspeople. They negotiate franchise agreements in a manner akin to negotiating a purchase of goods, despite the overwhelming power imbalance in favour of the franchisor. As the analysis presented in the previous sections has shown, even the legislative and judicial focus on franchising remains largely confined to examining the contractual implications of the relation, but in isolation, as if the contract defined a single moment when the minds of the franchisor and franchisee conjoined. It is in this context that recent regulatory retreats favouring franchisors occurred—the overarching principle seems to be “if it is contractual, let the parties decide the outcome.”

The perception that franchising is just another example of an entrepreneurial spirit that is harmed by legislative encroachment is, however, wrong. Franchising is a creature of legislation, as are all commercial relations. At a minimum, franchisors require protection of their intellectual property rights to create a franchise system. Franchise growth also depends upon certain competition law policies having favour; franchises in general depend on a certain regulatory framework that narrows the application—or relies on traditional definitions—of employment legislation. Where the regulatory environment strays from this, franchising may not take hold.

Evidence from Mexico bears this out. The government of Mexico enacted the Transfer of Technology Law [TTL] in 1972 in an attempt to protect Mexican interests by regulating foreign control over technology

170. For example, see Jirna, supra note 143.
171. See supra, Part II. For examination of how regulation does not infringe on the basic contractual structure, see Hadfield, supra note 7.
and providing for a central registry that reviewed all foreign contracts. Any agreements allowing franchisors to accept royalties that were disproportionate to the value of the acquired technology were disallowed. Under this regulatory framework, foreign franchises never developed a stronghold in Mexico. But when the TTL was repealed in 1991 and replaced with the Law for the Promotion and Protection of Industrial Property, all this changed. The new law made it much easier for foreign franchisors to establish outlets in Mexico, as recent figures showing a sudden proliferation of franchises in Mexico illustrate.174

It is difficult to understand why franchisors, franchisees and the umbrella associations alike are all reluctant to see government intervene to force changes to current franchise practices. The changed political climate in North America—with its aversion to regulation championed by the business community over the last two decades—may be one reason. Yet this explanation is not sufficient; if it were, it would assuredly translate into public complaints about governments regulating the status of corporations, partnerships or joint ventures, and generate newspaper editorials urging that common law principles of contract law and fraud adequately govern all aspects of commercial law.

Although this attitude only pervades thinking on franchising, perhaps if franchise relations were as simple as a relation between buyer and seller, there would be no need for additional regulatory involvement. The franchise relation is, however, unlike any other in business and, by this fact alone, deserves special treatment.

There are serious flaws in characterizing a franchise relationship in traditional contractual terms. To begin with, franchising is inherently unequal; franchise agreements are rarely, if at all, negotiated. That much is well-known and even accepted judicially. But legislative and judicial hesitation to use existing, though more flexible, analytical models—agent or fiduciary being the most obvious—is a sign that perhaps it is time to reformulate the idea of franchising. Relational contract theory provides a convenient starting point from which my development of a fidelity obligation derives.

2. Relational Contract Theory—An Overview

In relational contract theory, purely discrete transactions do not exist.175 Human interaction pervades virtually all relations on a number of

174. See Hammer, ibid. at notes 33–37 and at 835.
175. See Macaulay, supra note 27. He gives the example of a traveller on a long trip who drives into a service station and is told that she needs new tires. Both the station attendant and the motorist know that return business is very unlikely, and so the sale seems to be a discrete
different levels, whether through family, business or elsewhere. Moore, Macaulay, Macneil and others refer to this as relational behaviour. Relational behaviour is not governed as much by formalistic rules as it is by the discretion used to enforce these rules. This discretion exists in all normal relations.

Moore defined those whose regular interactions occur within this discretionary universe as operating within "semi-autonomous social fields." In many instances, external laws imposed upon these social fields do not succeed as they were intended to because of the elaborate and complex rules and codes developed extra-legally by the individual social system. Nonetheless, external laws often facilitate the allocation of scarce resources by acting as reciprocities that parties can bargain with, allowing a given social system to function smoothly. In a franchising context, acknowledging the relevance of this "private government perspective" requires rejecting neoclassical contract law principles.

The basic tenets of relational contract theory, largely attributable to Macneil, turn the traditional rules of contract law on their head. Classical contractual paradigms fixate on what Macneil labels the "transactional pole" (the discrete transaction), ignoring the continuum of contractual transaction. But Macaulay points out that this example has relational elements: the driver may hold a credit card, the credit card company may influence the practices of the service station, or the station could be a franchised dealership, etc. (at 3). See also I. Macneil, "Relational Contract: What We Do and Do Not Know" supra note 119. This issue of the Wisconsin Law Review includes a number of articles on relational contracts from a symposium dedicated to the body of work of Stewart Macaulay and Ian Macneil—it is highly recommended. Contrast this with classical contract theory which views contracts as discrete events (see Makar, supra note 2 at 731ff) or economic theories related to franchising which assume certain levels of discrete transactions depending upon the type of good (Makar at 753–54) or the location of the franchise (Makar, at 756). It seems that many of the current economic theories of franchising that favour less legislative intervention and more franchisor discretion rely on these outdated notions of discrete events.


177. Ibid. at 62–64. As Moore notes: "... call these 'moral' obligations, since they are obligations of relationship that are not legally enforceable, but which depend for their enforcement on the values of the relationship itself" (at 62). An interesting example of how extralegal remedies become formalized legally can be seen in standard provisions on remedying disputes found in some franchising agreements. It is now common to see a dispute resolution hierarchy whereby parties codify procedures by providing for a first-level middle manager meeting; if it cannot be resolved at this level, then the Vice-Presidents are given a certain time in which to resolve the problem, after which it falls to the Presidents of each company to attempt a resolution. It is my guess that these formal contractual provisions arose because the procedure makes intuitive sense and was probably used informally in the past. This is a slight adjustment to theories proposed by Scott about contract rules complementing extralegal mechanisms; see Scott, infra at note 186 and accompanying text.

178. See Macaulay, supra note 27 at 6–8.
behaviour that culminates in Macneil’s “relational pole”.\textsuperscript{179} In the pre-
scient view of a relational theorist, the traditional contractual model is far
too narrow to accommodate emerging relational, long-term arrange-
ments. Yet most modern commercial relationships are just that.

Franchising, especially business format franchising, is the apotheosis
of relational contract theory. It contains many of the components most
pertinent to Macneil’s relational contract model: the overriding impor-
tance of maintaining continuity in a relation; the presence of quantifiable
and nonquantifiable elements; the range of interaction that is often
present, from altruism to self-interest to conflict; the need for continual
planning, concentrating on flexible structures and procedures rather than
on single transactions; and an emphasis on restorative remedies instead
of replacement—all are characteristics of franchising.\textsuperscript{180} Standard trans-
actional models utilized in classical contract doctrine are ineffective in
dealing with many of these factors. If we are to accurately address the
character of relational arrangements, new principles and rules will need
to be formulated.\textsuperscript{181} For franchise relations, this translates into a regula-
tory framework that understands how, at times, commercial relationships
form webs of interdependence not unlike familial relationships or linked
corporate groups.\textsuperscript{182} The first-step in formulating a revised model of
franchising law is accepting that different norms of behaviour exist for
relational contracts. This may be simpler to understand for franchises as
compared to other long-term relations because of the relatively high level
of intimacy between the parties. The role of the extralegal is greater in
franchising because of the sophisticated licensing, trade-marking and
overall operational sharing between franchisor and franchisee.

Relational contract theory is, admittedly, not without its problems. It
is arguable that as contracts become more relational, formalities tend to
be downplayed, while non-material aspects of the relation become more
valued.\textsuperscript{183} This may present insurmountable difficulties because the rigid,
binary nature of judicial decision making makes courts ill-suited to deal
with diffuse problems. Furthermore, it is wrong to assume that long-term

\textsuperscript{179} See I.R. Macneil, \textit{Contracts, Exchange Transactions and Relations,} 2d ed. (Mineola,
47 S. Cal. L.Rev. 691 at 735–44. See also P. Selznick, in P. Nonet & H. Vollmer, eds., \textit{Law,
relate to collective bargaining, but they inform much of Macneil’s thinking on relational
contracts.

\textsuperscript{180} See \textit{Contracts, Exchange Transactions and Relations,} \textit{ibid.}

\textsuperscript{181} “Many Futures of Contracts”, \textit{ibid.} at 813–16.

\textsuperscript{182} See Sugarman & Teubner, \textit{supra} note 4.

\textsuperscript{183} See W. Whitford, unpublished memorandum, as discussed in Macaulay, \textit{supra} note 27
at 10.
relations, simply by virtue of their longevity, are without aspects of power imbalance. This is particularly true in franchising.\textsuperscript{184} Finally, it may be that rules of contract law are so entrenched in the psyche of contracting parties that these rules simply become subsumed under one aspect of the relation, and may in fact complement other, extralegal obligations.\textsuperscript{185} Thus, the use of a relational contractual model might be similarly incorporated into behavioural patterns over time.

All of these criticisms could be levelled at other legal models, including those developed for family law. As in any analytical model, the challenge in a franchising context is to construct a legal apparatus that complements the realities of business relations. Within this model, it must be acknowledged that understanding contractual relationships will necessarily be incomplete, but there is also an intimate link between legal rules and social norms that must be recognized.\textsuperscript{186} Any law must strike a balance between creating a flexible environment for franchisors to react to substandard franchisees, and the need for franchisors to accept the implicit value added to the franchise system by most franchisees. I have endeavoured to find this balance by creating a model for franchises adopted from both relational contract theories and family law, which I refer to as the fidelity model of franchising.

\textbf{IV. Fidelity Relations}

1. \textit{Introduction}

The franchise relationship \ldots does not fit neatly into any traditional common law category. It is not a master-servant relationship and it differs in important respects from both independent contractor and principal-agent relationships \ldots the franchisor \[\text{controls}\] the quality of the franchisee's goods and services. Such controls are typically more comprehensive than those found in the traditional independent contractor relationship, but the franchisee has greater independence and business discretion than the traditional agent. The franchise relationship is thus \textit{sui generis}.\textsuperscript{187}

\begin{thebibliography}{99}
\bibitem{184} See for example, C. Joerges, "Relational Contract Theory in a Comparative Perspective: Tensions Between Contract and Antitrust Law Principles in the Assessment of Contract Relations Between Automobile Manufacturers and Their Dealers in Germany" (1985) Wis. L. Rev. 581.
\bibitem{186} Scott, \textit{ibid.} at 2053–54.
\bibitem{187} G.L. Rudnick in \textit{How to Structure and Operate a Franchise System}. Papers from a conference May 17, 1984 at 7 (Franchise Forum, OYEZ Publishing 1982).
\end{thebibliography}
Even a cursory examination of current franchising practices reveals a multitude of sins that could be improved through judicial or legislative efforts. In many franchises, for example, the franchisee is required to disclose intimate details about its operation and provide the franchisor with access to confidential records and accounts. The franchisor can also inspect, supervise and discipline the franchisee. Moreover, most franchise agreements are so onerous that it is almost impossible for franchisees to maintain strict compliance with the terms and conditions imposed upon them—with the result that franchisees are probably often in technical default of the agreement. This allows a franchisor to hold over the franchisee’s head, like Damocles’ sword, the power to terminate the franchise; buttressed by non-competition covenants, a franchisor enjoys this luxury almost unilaterally because a franchisee is usually prevented by contract from competing, and is therefore much less likely to terminate.

Accordingly, redressing these problems in a real way requires, at a minimum, the following: (i) moving franchise relations away from a unitary legal model, contractual or otherwise, recognizing the various characteristics of independent contractors, fiduciaries, agents and employees, amongst others; and (ii) substantive judicial or legislative action that attempts to recast the form of the relationship, because the difficulty franchisees have in staying on-side of their franchise agreement will always allow franchisors to dominate the relationship. Simple contractual window-dressing will not be effective in controlling this.

2. Why Not Fiduciaries?

Fiduciaries, as discussed, are those acting in the interests of another party, entrusted with a power to affect those interests. The other party relies on, or is vulnerable to, this exercise of power. But where a party acknowledges having its own interests that must be protected and advanced, or where it is able to share in profits made, courts have difficulty finding a fiduciary duty. Since both franchisors and franchisees can be identified by a mutual desire to create profits, fiduciary law does not fit well within the franchise setting.

The fiduciary model could work well in protecting franchisees, but is not likely to find favour in Anglo-Canadian law, given the history of past caselaw. Nonetheless, the alternative does not have to be a complete lack of an obligation of confidence. Rather than making a clear, but dubious, distinction between fiduciaries and non-fiduciaries, demarcated by some magical allotment of factors related to the characteristics of a relationship, it may be more constructive to ground fiduciary duties at one end of a continuum of relations, where levels of obligation are continually
relaxed as one moves away from the fiduciary end. Fidelity duties could describe an area of this interregnum. At least one court has hinted at the feasibility of this concept.

Analytically, it is important not to attempt to solve the franchising dilemma by viewing the franchisor-franchisee relation as one between parties with unequal bargaining power; rather, it makes more sense to believe in the initial supposition of the parties that the relation will be long-term, with a common goal of profitability in the enterprise. In cases where there is a gross disparity of power, other legal remedies are available. On the other hand, many franchisees are highly sophisticated, have experienced counsel representing them, and are comfortable with the language of business. Courts rarely interfere in these instances. However, by raising expectations of a long-term commitment at the outset, and negotiating contract remedies that reflect such a commitment, parties can more efficiently allocate resources. In a number of ways, long-term contracts are thus analogous to marriage. As Gordon states:

parties treat their contracts more like marriages than like one-night stands. Obligations grow out of the commitment that they have made to one another, and the conventions that the trading community establishes for such commitments; they are not frozen at the initial moment of commitment, but change as circumstances change; the object of contracting is not primarily to allocate risks, but to signify a commitment to cooperate.

188. This seems to be a novel idea for fiduciaries, although it borrows from Macneil, supra note 175. In Lloyds Bank Ltd. v. Bundy, [1975] Q.B. 326 at 341, Sir Eric Sachs states that it was neither feasible nor desirable to attempt to closely define the fiduciary relationship or its characteristics. However, he goes on to add that the “demarcation line showing the exact transition point where a relationship that does not entail that duty passes into one that does . . .” implying a discrete separation of duties. This conceptualization remains undisputed. On the other hand, I may be misclassifying commercial associations into a new category that obfuscates further, rather than attempting to reify franchise relationships: see A.A. Leff, “Contract as Thing” (1970) 19 Am. U. L. Rev. 131.

189. See Litwin Construction, supra note 134. The Court there spoke of graduated standards of honesty that may be applied in commercial relations. These could include discrete steps such as (1) duty not to act unconscionably; (2) duty to deal fairly; (3) duty to act in good faith; and (4) duty to act in utmost good faith, for example.

190. See Jirna, supra note 143 and Hospital Products, supra note 147 for example.

191. A change to a family law model may simply act as another legal resource for parties to use in internal bargaining. Moore describes how much of the legal rights imposed by statute can be interpreted as the capacity of persons inside a particular social field to mobilize the state on their behalf. For those who, by virtue of the necessities of their position, must occasionally act outside the law, the legal rules provide leverage in bargaining for benefits in other instances—see Moore, supra note 176 at 63-65.

Although any reconception of legal rules may be “subverted” in this manner, it is argued that reformulating franchising rules to a fidelity model will provide a better balance of these bargaining rights—see infra at note 193 and accompanying text.

This analogy is highly instructive when applied to the most common problem in franchising—termination of the relationship.

3. Terminating Franchise Relationships—The Fidelity Model

Most franchise laws deal with the problem of termination by requiring good cause prior to a party terminating the arrangement. This approach creates several problems. First, it has resulted in excessive litigation, ostensibly to determine the subjective meaning of good cause. But more fundamentally, does termination for good cause really produce the desired result? Is it not the objective, in terminating any long-term relation, to allow parties to ensure that a break-up is not only final but, ultimately, fair? Developments in family law over the last twenty-five years have shown the value in allowing divorces without cause, equitable division of assets upon marriage breakdown, and allowing parties to make a clean break and start over (excluding possible issues related to support that may require ongoing attention). Many of these principles could be modified for use in a franchising law context. The two competing interests that modern divorce law tries to protect—ease of separation, because the state has little interest in ensuring the continuity of failed relationships, and equitable apportioning of value realized during the relationship—have their counterparts in franchising. Arguably, it would be better to grant, with some minor restrictions, easier rights of termination to both franchisors and franchisees, for much the same reason. Franchisors may need to act quickly to protect trade-marks, for example. Franchisees may wish to terminate if losses become unmanageable or other opportunities present themselves. On the other hand, there is a need to value the effort put into the franchise by both parties, even in cases where one party is in default of the agreement. This could be accomplished by implementing a simple termination formula, as used in family law, calculated to take into account the value brought into

relations is common parlance in everyday business dealings between companies: parties talk of “consummating their relationship” after a transaction; of not wanting to “go to bed” with another company until intimate details of the other are known.

193. See Pitegoff, supra note 15 at 297.
194. The Preamble to the Family Law Act, R.S.O. 1990, c. F.3 is instructional in this regard: “Whereas it is desirable to encourage and strengthen the role of the family; and whereas for that purpose it is necessary to recognize the equal position of spouses as individuals within marriage and to recognize marriage as a form of partnership; and whereas in support of such recognition it is necessary to provide in law for the orderly and equitable settlement of the affairs of the spouses upon the breakdown of the partnership, and to provide for other mutual obligations in family relationships, including the equitable sharing by parents of responsibility for their children.”
the relationship by both parties, as well as the value accrued over the
course of the relationship. Adding up the equities in this way would
protect both parties, since it would correct for longevity—in most cases
the initial contribution to the franchise comes largely from the franchisor,
but over time a franchisee’s value to the franchise will most likely
increase.\textsuperscript{195} Under this formula, termination could occur at any time,
subject perhaps to an established minimum, without detrimental effects
to the long-standing franchisee.

Similarly, termination of franchises could trigger certain minimum
amounts payable to the franchisee, as employees are currently protected
under employment standards legislation. These amounts could be based
on a combination of average revenues or profits and include the amortized
value of initial capital expenditures.

The fidelity concept could also circumvent problems that arise with the
fiduciary model. Most courts tend to view a commercial relation (espe-
cially fiduciaries) as fixed at the time of contracting, so will always make
a determination of status based on the parties’ intent and the words of the
contract. A fidelity model, like Macneil’s relational contractual ideal,
recognizes how relationships develop over time. Dependency that was
not present initially can set in after a number of years, altering the
character and dynamics of a relationship. Acknowledging this should be
a goal of any system of commercial justice. A fidelity model, as de-
scribed, would assess this aspect of a commercial relationship and thus
better understand the true nature of a commercial relation.

In simple terms, there is a need for equity to acknowledge that a
franchisee is entitled to a reasonable opportunity to succeed.\textsuperscript{196} If this
formed the basis of a fidelity model, other aspects of a franchising
relationship could be clarified. Within limits, restraints could be imposed
upon the amount of initial capitalization required from franchisees. The
maximum amount of royalties and other charges that franchisors could
levy on franchisees could be curtailed, so that sufficient revenues remain
for franchisees to obtain a fair return on their investment. And to prevent
repeating the service station experience\textsuperscript{197} or that described in \textit{Avos
Holdings},\textsuperscript{198} a franchisee could be assured, as far as reasonable rules of
competition apply, of freedom from indirect and direct competition from
its franchisor. As Harold Brown concludes, franchisees should be consid-
ered independent businesses, entitled to fully protect their assets in the

\textsuperscript{195} See J.A. Brickley, F.H. Dark & M.S. Weisbach, “The Economic Effects of Franchise
\textsuperscript{196} See Brown, \textit{supra} note 12 at 674–75.
\textsuperscript{197} See \textit{supra} note 67.
\textsuperscript{198} \textit{Supra} note 117.
same manner as the law affords other businesses. 199 I believe we should go further and recognize the distinct nature of franchising.

The theoretical basis for providing remedies for breach of contract, breach of *Hedley Byrne* duty, or breach of fiduciary duty, is to protect reasonable reliance arising from an undertaking. This should form the basis for sustaining a fidelity relationship. Just as the fiduciary principle is resorted to in some instances in order to get a broader remedy (where damages will not suffice), it is hoped that a form of fidelity relation may invoke a more suitable and just method for courts to use in formulating franchising remedies.

**Conclusion**

I do not presume to know whether businesspersons and their legal advisors enjoy maintaining the *status quo* out of ignorance or indolence, or use cumbersome and complicated laws in order to restrict access and ensure the continuation of certain practices. It could be argued that the doctrines of contract law, when applied to franchising, foster all of these behaviours. Most common law contract remedies must be savagely twisted out of shape in order to work for long-term franchising relations. The same holds true for legislative remedies aimed at franchising. Those that are not modelled solely along the lines of common law contract theory are regulatory minefields, pathetically ineffective in granting relief to both potential and existing franchisees.

The current system of law for franchising is costly and inefficient. Legislation, modelled along statutes enacted for the protection of families and family property, could begin to alleviate the concerns of both franchisors and franchisees and present a fairer foundation with which they could commence a discrete business relationship. And if judges re-imagined things, they would see that franchising relationships are *sui generis*, unbridled by limitations placed on present categories of fiduciaries, employees, agents or independents. Unfortunately, as long as the law remains fixated on traditional contractual approaches to remedying franchise disputes, no one really benefits.

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