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Two Ambiguities in the Franchising Regulation Bill, 2022:

The “Franchisor’s Associate” and “Similar Business” Provisions

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Introduction

In 2023, the Franchising Regulation Bill (the "**Bill**") was passed by the Nigerian Senate to establish a framework for the regulation of franchising in Nigeria.[1] The Bill has not yet been assented to by the President and is therefore not yet law. The Bill seeks to provide a comprehensive framework for franchising in Nigeria and to protect the interests of both the franchisor and franchisee. The Bill covers various aspects of franchising such as disclosure, termination, and dispute resolution. The Bill also proposes the National Office for Technology Acquisition and Promotion as the regulatory body for the Bill, when passed.

The Bill has been lauded for being innovative as, prior to its introduction, there was no definite regulatory framework for franchising in Nigeria. Despite the positive reception, certain provisions of the Bill remain ambiguous and unclear, and are in the need of reform. This article aims to review these provisions, and to propose ways forward on them.

What is Franchising?

Franchising is a business model that allows a company to expand its brand and operations through a network of persons who operate under the company's name and guidelines. According to the International Franchise Association, a franchise is 'the agreement or licence between two legally independent parties which gives – a person or group of people (franchisee) the right to market a product or service using the trademark or trade name of another business (franchisor).'[2] In a franchise arrangement, there exist two main parties: the franchisor and the franchisee. The franchisor is the person who grants the franchise while the franchisee is the person to whom a franchise is granted. While the Bill covers these aspects, it also makes reference to a third party who it describes as the franchisor's associate (hereinafter "associate"). The "associate", like the franchisor, can also enter into a franchise agreement with the franchisee.

Who is an "Associate"?

S. 21(1) of the Bill, which is the Interpretation Section, defines a Franchisor's "associate" as:

> *"A person*
>
> *a. Who, directly or indirectly,*
> *i. controls the franchisor,*
> *ii. is controlled by the franchisor, or*
> *iii. is controlled by another person who also directly or indirectly controls the franchisor; and*

[1] Press Release, 'Senate passes Federal High Court amendment, Franchising Establishment Bills' (*Premium times*, 25 January 2023) <https://www.premiumtimesng.com/news/top-news/577712-senate-passes-federal-high-court-amendment-franchising-establishment-bills.html> accessed 8 February 2023.

[2] Franchise Direct, 'What is Franchising? Definition and Meaning' (*Franchise Direct*, Undated) <https://www.franchisedirect.co.uk/franchising-definition-meaning/> accessed 8 February, 2023.

b. Who

i. is directly involved in the grant of the franchise by being involved in reviewing or approving the grant, or by making representations to the prospective franchisee on behalf of the franchisor for the purpose of granting the franchise, marketing the franchise, or otherwise offering to grant the franchise, or

ii. exercises significant operational control over the franchisee and to whom the franchisee has a continuing financial obligation in respect of the franchise."

From this definition, the "associate" must meet the following requirements:

i. ***Must be a person:***

The "associate" must be a person. S. 21(1) of the Bill defines a person to include individuals, partnerships, trustees, and unincorporated associations/organizations.

ii. ***Element of "control"***:

By the provisions of the Bill, the "associate" must control or be controlled by the franchisor. In the alternative, the "associate" may be controlled by the same person that controls the franchisor.

The vagueness in this definition prompts the question *"what exactly is control?"* On the issue of "control", s. 21(2) of the Bill provides that a corporation is controlled by another person if the corporation's voting securities carrying more than 50 percent of the votes for the election of directors are held, otherwise than by way of security, only by or for the benefit of the other person; and the votes carried by those securities are entitled, if exercised, to elect a majority of the corporation's board of directors.

Other legislation has provided different views on "control". The Companies and Allied Matters Act, 2020 provides that a person with significant "control" is one who holds directly or indirectly, 5% of the shares or voting rights in a company or limited liability partnership or who has the right to exercise or exercises significant control or influence over the company or limited liability partnership.[3]

The Federal Competition and Consumer Protection Act, 2018, in defining what amounts to "control" in a merger, provides that an undertaking has "control" over the business of another undertaking if it beneficially owns more than one half of the issued share capital or assets of the undertaking; is entitled to cast a majority of the votes that may be cast at a general meeting; is able to appoint or to veto the appointment of a majority of the directors of the undertaking; is a holding company, and the undertaking is a subsidiary of that company; where the undertaking is a trust, has the ability to "control" the majority of the votes of the trustees; and has the ability to materially influence the policy of the undertaking

[3] S. 868, Companies and Allied Matters Act, 2020.

in a manner comparable to a person who, in ordinary practice, can exercise an element of control referred in the previous instances.[4]

Unfortunately, this Bill only envisages a situation where the franchisor is a juristic person. What if the franchisor is an individual or a partnership? How would control be determined? This definition of control also does not include situations when the "associate" is controlled by the franchisor.

iii. ***"Involvement" in the Grant of the Franchise:***

In addition to "control", the "associate" may also be involved in the grant of the franchise by reviewing or approving the grant or making representations to the prospective franchisee on behalf of the franchisor. The question is 'to what extent does a person have to be involved to meet this requirement?' The threshold does not seem to be high when considering the level of involvement required. For instance, reviewing the grant might not require a high level of authority. Likewise, making representations to the prospective franchisee for the purpose of marketing the franchise might require little authority as well. This means that some junior employees may qualify to be regarded as "associates".

iv. ***Significant Operational Control and Continuing Financial Obligation***

The Bill also provides that the franchisor may also be a person with "significant operational control" over the franchisor and to whom the franchisee has a continuing financial obligation in respect of the franchise. The Bill, however, does not define what "operational control" and "continuing financial obligation" mean.

The ambiguous language used in s. 21(1) can be interpreted to include directors, officers, majority shareholders, and related companies. In fact, anyone who may make representations to the prospective franchisee on behalf of the franchisor in respect of the franchise agreement may be regarded as an "associate". A literal interpretation of s. 21(1) might also lead one to infer that an employee may also be regarded as an "associate" since the section includes phrases like *"controlled by the franchisor"* and *"makes representations to the prospective franchisee on behalf of the franchisor"*. The Bill also treats the franchisor and "associate" as related parties that share duties, and the associate's relationship with the franchisor bear some similarities with an agency relationship.

In Canada, franchising is regulated by provincial statutes. The Franchises Act of British Columbia, 2015; The Franchises Act of Manitoba, 2012; The Franchises Act of New Brunswick, 2014; The Franchises Act of Alberta, 2000; The Franchises Act of Prince Edward Islands, 1988 and The Arthur Wishart Act (Franchise Disclosure) 2000 of Ontario have similar definitions of an "associate" with the Bill. The Acts appear to have inspired the Bill, and they define an "associate" as a person:

> *"a. who, directly or indirectly,*
> *i. controls the franchisor,*

[4] S. 92(2), Federal Competition and Consumer Protection Act, 2018.

ii. is controlled by the franchisor, or

iii. is controlled by another person who also directly or indirectly controls the franchisor; and

b. who

i. is directly involved in the grant of the franchise,

A. by being involved in reviewing or approving the grant of the franchise, or

B. or by making representations to the prospective franchisee on behalf of the franchisor for the purpose of granting the franchise, marketing the franchise, or otherwise offering to grant the franchise, or

C. exercises significant operational control over the franchisee and to whom the franchisee has a continuing financial obligation in respect of the franchise."

For instance, an "associate" could be a parent company, director, partner, or other entity that has significant influence over the franchisor. The "associate" could also be someone involved in the franchisor's supply chain or who provides financing to the franchisee. The Canadian franchise legislation also subject the "associate" to the same disclosure requirements as the franchisor where the "associate" has a significant influence over the franchisor's management or business operations.

The definition of an "associate" in the Canadian legislations is broad. The Courts have interpreted the definition to ensure that the purpose of the legislation, which is to protect franchisees, is met. In *Ontario Ltd. v Dig This Garden Retailers Ltd.,*[5] the Canadian Court found majority shareholders who were involved in the running of a franchise to be "associates".[6] Also, a sub-landlord controlled by the same individual who controlled the franchisor was held to be an "associate" in *Ontario Inc. et al. v Dollar It Ltd. et al.*[7] The sub-landlord was held to exercise "significant operational control" over the franchisee. The franchisee was held to have a continuing financial obligation to it for rental payments for the property where the franchise is run.[8]

Who bears the liability between the franchisor and "associate"?

It is important to consider the question of the liability of the "associate". The Bill does not state who bears the liability between the franchisor and the "associate". The Bill also does not stipulate

[5] (2005) CanLII 25181, (2005), 256 DLR (4th) 451 (Ont. CA).
[6] Betheboss, 'What is a Franchisor's Associate and Why Should a Franchisor Care?' (*Be The Boss*, Undated) <https://www.betheboss.ca/resources/franchise-articles/what-is-franchisors-associate-why-franchisor-care> accessed 8 February 2023.
[7] (2009) ONCA 385 (Ont CA).
[8] Jonathan Mesiano-Crookston, 'Franchisor's Associates' (*Goldman Hine LLP*, Undated) <https://www.goldmanhine.com/2018/09/06/franchisors-associates/> accessed 8 February 2023.

the extent of such liability. The extent of the liability borne by the "associate" will depend on the franchise agreement and nature of the relationship between the "associate" and franchisor.

In some instances, the "associate" may be held liable for the franchisor's actions. However, this depends on the terms of the agreement between them. The franchisor and the "associate" may have an agreement that limits the scope of liability either of them may incur. The franchise agreement may also provide that the "associate" will not be personally liable in respect of any matter in the agreement.

In other instances, one may assume that the franchisor would be automatically liable for the actions of the "associate" with regard to the franchise agreement. In the case of *Addison Chevrolet Buick GMC Ltd. v. General Motors of Canada Ltd.*[9], the Ontario Court of Appeal held that "associates" owe a duty of care to franchisees and may be liable to franchisees where they breach this duty.

In franchising statutes in other jurisdictions, there are provisions on the liability of the franchisor's associate and the extent of the franchisor's associate's liability. It would have been preferable for the Bill to stipulate this. In Australia for instance, the Franchising Code of Conduct (the "**Code**") defines an "associate" to include directors, related entities, a partner, a shareholder that holds or controls at least 15% of the shares in the franchisor entity, and any person that has a relation that is "relevant to the franchising system."[10]

The "associate" must act in good faith,[11] prepare the disclosure document, and must ensure that it is accurate and complies with the requirements of the Code. If the disclosure document is misleading or inaccurate, and causes loss to the franchisee, both the franchisor and the "associate" will be held liable for any losses incurred by the franchisee. The Bill imposes similar obligations on the franchisor and the "associate". The "associate" is subject to certain civil liabilities for non-compliance with certain provisions of the Bill imposing such obligations.

The broad and vague definition of the term "associate" exposes to potential liability the directors, officers, and employees of franchisor companies and may even capture persons who might not think they are related to the franchisor. Franchisors must be appropriately prepared for the resulting liability, possibly by structuring and documenting their legal relationships to minimize this risk.

Similar Business

S.12(2) of the Bill, provides that franchisees shall not carry out "any other business similar to the franchised business" during the term of the franchise. S. 12(3) also extends this obligation to the directors and employees of the franchisee company.

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[9] Law Works, 'Ontario Court of Appeal opens door to liability of franchisors' associates for bad faith' (*Law Works*, Undated) <https://www.lawworks.ca/franchise-disclosure-document/ontario-court-appeal-opens-door-liability-franchisors-associates-bad-faith/> accessed 1 March 2023.
[10] Article 4, Competition and Consumer (Industry Codes - Franchising) Regulation, No. 168, 2014.
[11] Article 6, *Ibid*.

While the purpose of the provision is to protect the franchisor, the phrase "similar business" is vague. One may infer that the provision prohibits the franchisee from engaging in another franchise agreement or a business similar in nature to that of the franchisor. However, this provision needs to be properly defined considering its broad applicability to employees and directors of the franchise company. For instance, while it might be understandable that this restriction should apply to directors because of their role in the franchise agreement and possible access to the information contained in the operating manual, it would be far-reaching to extend this provision to all employees because not all employees of the franchised business would be privy to the trade secrets or information disclosed in the operating manual.

In a Canadian Court, the Court held that a clause in a franchise agreement which prohibits franchisees from engaging in similar businesses may not be enforceable in all circumstances against the franchisee. In the case of *MEDIchair LP v DME Medequip Inc.*[12], the Canadian Court of Appeal did not enforce such clause because the evidence showed that the franchisor was not going to open a store within the restricted area. The Court held that this clause must protect 'the legitimate interest of the franchisor', but cannot extend beyond that.[13]

It would have been prudent for the statute to include a definition of the term "similar business", to avoid interpretations that extend beyond the scope intended by the Draftsman.

Conclusion

In conclusion, the Franchise Regulation Bill is a positive development for the franchising industry in Nigeria. If passed into law, it will provide a legal framework for the development and growth of franchising in Nigeria, and tend to ensure the protection of franchisees and franchisors. It will also stimulate the growth of the franchising sector in Nigeria and provide a much-needed boost to the economy.

However, there is a need to revisit some sections of the Bill to provide more clarity. Given the important roles that the franchisor's "associate" play, it is important to determine who may be legally considered to be an "associate". The provision of the Bill concerning this is ambiguous and does not clearly describe whether the "associate" is an affiliate or an independent company, if the franchisor would be responsible for the "associate" or if the "associate" will be independent and responsible for themselves. Considering that the Bill imposes similar duties and liabilities on a franchisor's "associate" in the franchise agreement, it is important that the term is properly defined to avoid controversies and legal issues. Likewise, the term "similar business" also needs to be defined as its usage is open to unfortunate interpretations and restrictions.

It does not seem prudent that some sections of the Bill are ambiguous and open to several interpretations. If passed into law, these vague sections may stir controversies that may need much judicial interpretation for proper clarification.

[12] 2016 ONCA 168.

[13] Betheboss, *Op Cit*, p. 3.

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