

The Legal Relevance of Bargaining Power in U.S. and Canadian Franchise Litigation: A Comparative Perspective North and South of the Border

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The paradigm of a “typical” franchise transaction involves a single franchised unit, granted to a relatively unsophisticated franchisee, using the franchisor’s system-uniform franchise agreement without negotiation.¹ The common use of system-uniform franchise agreements by franchisors is widely accepted as a necessary requirement of a properly functioning franchise network, facilitating the franchisor’s management and administration of the system and providing for equal treatment



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1. See, e.g., Gillian Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 STAN. L. REV. 927, 961 (1990) (“... the refusal of the franchisor to negotiate—the superior position of the franchisor—is a hallmark of the relationship”); Elizabeth C. Spencer, *Consequences of the Interaction of Standard Form and Relational Contracting in Franchising*, 29 FRANCHISE L.J. 31, 32 (2009) (“widely accepted within the sector that franchise contracts are not negotiated. Some minor adjustments may be countenanced . . .”); Peter C. Lagarias & Edward Kushell, *Fair Franchise Agreements from the Franchisee Perspective*, 33 FRANCHISE L.J. 3, 6 (2013) (“[m]any franchisors simply do not negotiate franchise agreements. Even in the minority of franchise systems where negotiation occurs, franchisors typically negotiate only a few provisions with limited changes.”); HAROLD BROWN, J. MICHAEL DADY, JEFFERY S. HAFF & RONALD K. GARDNER, FRANCHISING REALITIES AND REMEDIES § 1.03[4] (2004) (“the franchisor often tells the franchisee, ‘[w]e won’t negotiate any terms. . . . As a result, the franchisee is badly uninformed and will sign anything put in front of him or her by the franchisor without really understanding the documents.’”); Kevin Adler, *Negotiating Franchise Contracts*, FRANCHISING BUS. & LAW ALERT (July 2013) (describing franchisor’s “take-it-or-leave-it attitude about their form contract”); DAVID N. KORHAUSER & MICHAEL A. KLEINMAN, FRANCHISEE ASSOCIATIONS IN CANADA 91 (2011). (“Franchisees rarely have the opportunity to negotiate the terms of franchise agreements.”).

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of franchisees.² Nevertheless, franchisors' "take it or leave it" approach to typical franchise transactions has led a number of appellate courts in the United States³ and Canada⁴ to characterize franchise agreements as contracts of adhesion in certain circumstances, with attendant legal implications for the franchisor in the underlying litigation. Although it is an open question as to whether the adhesive characterization in these cases is persuasive,⁵ the existing jurisprudence makes this a live issue, warranting special consideration.

In particular, franchise transactions are increasingly falling outside the typical paradigm of a "take it or leave it" negotiation, and the usual justifications supporting characterizing a franchise agreement as adhesive break down in those circumstances. In the United States, franchise transactions in recent years have increasingly involved economically sophisticated franchisees, either private equity investors or wealthy individuals, who will not simply sign the standard form agreement.⁶ In addition, negotiation over material business terms is commonplace where the underlying transaction covers multiple units, large exclusive territories, and/or the franchisee's ability to subfranchise.⁷ Further, as many franchise lawyers know, franchisors early in their business lifecycles are much more likely to entertain amendments to their standard form agreements to help establish an initial network of franchisees. In all of these circumstances, the franchisee is much more

2. See, e.g., Ernst Braun, *Policy Issues of Franchising*, 14 SW. L. REV. 155 (1984) ("[B]argaining freedom . . . appears to be incompatible with maintenance of a franchise system"), cited in James Jordan & Judith Gitterman, *Franchise Agreements: Contracts of Adhesion?*, 16 FRANCHISE L.J. 14, 42, 45 (1996) (" . . . franchisees benefit from standardization" which is " . . . essential in a franchising system"); Adler, *supra* note 1 ("Uniform contracts ease management of brand identity, enable franchisors to change the system in a lock-step fashion when necessary, simplify contract administration, provide equal treatment of all franchisees, and can be written to minimize the risk of adverse outcomes in litigation."); KORNHAUSER & KLEINMAN, *supra* note 1, at 91 ("Uniformity and consistency of operations is a primary goal.").

3. See cases cited in *infra* notes 17 and 18 and accompanying text.

4. See cases cited in *infra* notes 43 and 44 and accompanying text.

5. See, e.g., Jordan & Gitterman, *supra* note 2, at 41 (franchising is a "far cry from the circumstances of a true contract of adhesion"); Carmen Caruso, Bethany Appleby & Griffith Towle, *Unconscionability and Franchise Litigation*, ABA FORUM ON FRANCHISING (2006); Braun, *supra* note 2, at 244; see also, e.g., *Shaffer v. Graybill*, 68 F.App'x 374, 377 (3d Cir. 2003).

6. Adler, *supra* note 1 (" . . . private investment groups and wealthy, experienced business owners have showed increased interest in purchasing franchisees"); BROWN ET AL., *supra* note 1, §§ 1.03[4], 1-28.5; Caruso et al., *supra* note 5 (" . . . growing phenomenon of the economically sophisticated franchisee . . ."), citing John Bear et al., *Franchising: Distribution Model for the Millennium?*, ABA FORUM ON FRANCHISING § 1-4, at 26 (1999).

7. Ronald Gardner, Anne Hurwitz, Francesca Turitto & Larry Weinberg, *Key Issues When Advising Master Franchisees and Area Developments (and Franchisors)*, 11:3 INT'L J. OF FRANCHISING LAW 15 (2013) ("Many master franchisees and area developers are often better capitalized than the franchisor and often represent multiple brands, thus possibly changing the negotiating dynamics"); Frank Zaid, *International Franchise Agreements: Research, Risk and Reward*, 2:5 INT. J. OF FRANCHISING L. 6 (2004) ("It is also essential that the franchisor [expanding internationally] understands that virtually all of the terms contained in its current form of domestic franchise agreement will be open to negotiation . . ."); Adler, *supra* note 1 (discussing "private equity investors . . . seeking to operate many franchise outlets or to control large, exclusive territories . . . [and] individual owner-operates [with] extensive . . . experience [and] management team[s] to operate additional outlets").

likely to exercise meaningful bargaining power in franchise agreement negotiation because of its economic sophistication relative to the franchisor, the size and scope of the underlying transaction, or both. Although precise statistics as to the prevalence of atypical franchise transactions are difficult to find, at least one source reports that over half of franchised units in the United States are owned by multiunit franchisees.⁸

In other circumstances, although individual franchisees may sign the standard form franchise agreement without negotiating the underlying terms, the franchisor previously elected to engage in meaningful contract negotiations with a representative group of franchisees, i.e., franchisee associations.⁹ Although the overall prevalence of strong franchisee associations may be statistically low,¹⁰ their participation in certain negotiations over franchise agreement terms appears inconsistent with the notion that these particular contracts are adhesive.¹¹ Franchisors may be more willing to negotiate with franchisee associations if the law were prepared to recognize the reality that, in those circumstances, the resulting agreement is anything but adhesive.¹² Recent Quebec case law does precisely this and provides a persuasive framework for other courts to consider when this issue confronts them.¹³

The purpose of this article is to investigate the circumstances in which courts in the United States and Canada have been inclined to characterize franchise agreements as negotiated commercial contracts, rather than as contracts

8. Darrel Johnson, *What's Driving Multi-Unit Growth?*, FRANCHISING.COM, http://www.franchising.com/articles/whats_driving_multiunit_growth.html (last visited Feb. 13, 2015).

9. Thomas M. Pitegoff, *Franchise Relationship Laws: A Minefield for Franchisors*, 45 BUS. LAW 289, 314–15 (1989) (“... there is far less inequality today... as franchisee associations are wielding more power than ever”); Carla Wong McMillian, *What Will It Take to Get You in a New Car Today?: A Proposal for a New Federal Automobile Dealer Act*, 45 GONZ. L. REV. 67, 87 (2010) (“... franchise associations... often negotiate the terms of these contracts on behalf of large groups of franchisees”); Mary deLeo, Note, *Emasculating Goliath: Did Postal Instant Press v. Sealy Strike an Unfair Blow at the Franchising Industry?*, 25 W. ST. U. L. REV. 117, 163 n.279 (1997) (“The recent emergence of strong, sophisticated franchisees, coupled with the advent of franchisee associations, has led to a realignment of power in some franchise systems, and the ‘take it or leave it’ attitudes typical of franchisors in the 1970s and 1980s are giving way...”); Caruso et al., *supra* note 5 (noting the “increasing franchisee efforts to engage in ‘collective bargaining’ through independent franchisee associations, or umbrella associations...”).

10. Robert W. Emerson & Uri Benoliel, *Can Franchisee Associations Serve as a Substitute for Franchisee Protection Laws?* 118:1 PENN. ST. L. REV. 99, 126–28 (2013) (citing industry evidence to the effect that successful associations exist in only 4 percent of U.S. franchise systems).

11. See KORNHAUSER & KLEINMAN, *supra* note 1, at 93–94 (“... the leverage [a strong association] enjoys enhances its ability to... effect changes to the system”).

12. No positive obligation on franchisors to negotiate with franchisee associations has been recognized by courts in Canada. However, in the five Canadian provinces that have franchise legislation (Ontario, Alberta, Manitoba, New Brunswick, and Prince Edward Island), franchisors are statutorily prohibited from interfering with the right of franchisees to associate with one another: Ontario: Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c. 3, s. 4 (Can.); Alberta: Franchises Act, R.S.A. 2000, c. F-23, s. 8 (Can.); Manitoba: The Franchises Act, C.C.S.M. c. F156, s. 4 (Can.); New Brunswick: Franchises Act, S.N.B. 2007, s. 4, c. F-23.5 (Can.); Prince Edward Island: Franchises Act, R.S.P.E.I. 1988, c. F-14.1 (Can.).

13. See cases cited at *infra* note 69 and accompanying text. Quebec is the only Canadian province with a civil (rather than common) law tradition. Moreover, there is no franchise-specific legislation in force in Quebec.

of adhesion, in order to delineate the types of evidence and factors to which franchisors can point to resist the adhesive label in franchise litigation. Rather than enter the current debate as to whether the “take it or leave it” approach found in the typical franchise transaction properly supports the adhesive label, this article reviews the existing case law where courts on both sides of the border have rejected the adhesive characterization, providing an evidentiary framework for future cases. Although not U.S. lawyers, the authors focused on this discrete area of U.S. franchise litigation because the underlying legal principles are substantially similar to those applied in Canada. As described below, the applicable case law in both countries provides a useful evidentiary framework for U.S. and Canadian franchise litigators who face this issue in their practice.

This article is structured into three parts. The first part canvasses the U.S. case law in which franchise agreements have been labelled as adhesive and distills the key legal consequences that have flowed from the label. The second part provides a parallel analysis of similar Canadian case law, including that in Quebec. Finally, the article analyzes cases in both jurisdictions where courts have rejected the adhesive label and identifies the key evidentiary factors that motivated their analyses. The article concludes with a suggested framework for use in subsequent cases.

I. Consequences of Characterizing a Franchise Agreement as Adhesive in the United States

In the United States, the general law of contracts recognizes, through the concept “contract of adhesion,” that certain types of agreements may contain standard-form language imposed by the party with superior bargaining strength. Although the phrase “contract of adhesion” finds its genesis in French civil law, it was first incorporated into the U.S. legal vocabulary through an influential law review article on insurance policies published in 1919.¹⁴ The concept is now referred to in leading U.S. treatises on contract law, specifically in relation to the interpretive doctrine, *contra proferentem*, under which drafting ambiguities are resolved against the drafter.¹⁵ A contract is considered adhesive where there is a significant inequality of bargaining power between the contracting parties, such that the stronger party im-

14. This was recognized in Jordan & Gitterman, *supra* note 2, at 15, citing Edwin W. Patterson, *The Delivery of a Life Insurance Policy*, 33:2 HARV. L. REV. 198, 222 (1919); see also MICHAEL FURMSTON, CHESHIRE, FIFOOT & FURMSTON'S LAW OF CONTRACT 27 (16th ed. 2012) (“The French, though not the English, . . . have a name for it[:] *contract d'adhesion*”).

15. WILLISTON ON CONTRACTS § 32:12 (4th ed.) (“Any contract of adhesion, which is a contract entered into without any meaningful negotiation by a party with inferior bargaining power, is particularly susceptible to the rule that ambiguities will be construed against the drafter.”); E. ALLAN FARNSWORTH, 2 FARNSWORTH ON CONTRACTS § 7:11, at 5 (3d ed.) (“Interpretation of *contra proferentem* is much favored in the context of standard form contracts, particularly if adhesive” [emphasis added]).

poses the terms and conditions on the weaker party, effectively on a “take it or leave it” basis.¹⁶

A number of federal¹⁷ and state¹⁸ appellate courts have recognized that franchise agreements may contain the hallmarks of adhesiveness in the sense that they are not subject to meaningful negotiation but instead are imposed by the franchisor on a “take it or leave it” basis. Although U.S. courts are hardly unanimous in this view,¹⁹ there is sufficient precedent to make this a live issue, the implications of which warrant special consideration. A finding that a particular franchise agreement is adhesive has at least four potential consequences in U.S. franchise litigation:

First, as noted, leading treatises on contract law have recognized that *contra proferentem* has wider application to contracts of adhesion than to fully negotiated agreements,²⁰ likely on the basis that it is easier to identify the drafter of adhesive contracts and thus the party against whom interpretive ambiguities are to be resolved. Indeed, a number of appellate courts have suggested that *contra proferentem* may apply more strictly to adhesive contracts. In *Abbott v. Amoco Oil Co.*, a nonfranchise case, the Appellate Court of Illinois held that “generally, burdensome clauses in adhesion contracts should be construed against the more powerful party.”²¹ Similarly, in *Semmes Motors v. Ford Motor Co.*, the Second Circuit held that *contra proferentem* “applies with particular force in cases of standardized contracts and in

16. Patterson, *supra* note 14, at 222; WILLISTON, *supra* note 15, § 32:12.

17. See, e.g., *Auwah v. Coverall N. Am., Inc.*, 554 F.3d 7, 12 (1st Cir. 2009) (“Franchise agreements are often contracts of adhesion offered to those with little bargaining power”); *Semmes Motors v. Ford Motor Co.*, 429 F.2d 1197, 1206–07 (2d Cir. 1970) (the court applied *contra proferentem* to a franchise agreement because it falls into the category of “standardized contracts . . . where the drafting party has the stronger bargaining position”); *Ticknor v. Choice Hotels Int’l, Inc.*, 265 F.3d 931, 939–40 (9th Cir. 2001) (finding that a franchise agreement was adhesive on the basis that it was a “standardized, form agreement that [the franchisee] was forced to accept or reject without negotiation”).

18. *Kubis & Perszyk Assocs., Inc. v. Sun Microsystems, Inc.*, 680 A.2d 618, 627–29 (N.J. 1996) (“the vast majority of franchise agreements do not fit into th[e] category . . . [of being] freely negotiated by responsible parties of comparable bargaining power”); *Watson v. Waffle House, Inc.* 324 S.E.2d 175 (Ga. 1985) (finding that the strict scrutiny accorded to restrictive covenants found in employment contracts applied to “franchise agreements” because they were “contracts of adhesion”); see also *Jordan & Gitterman, supra* note 2, at 15–16, 41, citing *Keating v. Super. Ct.*, 645 P.2d 1192 (Cal. 1982); *Postal Instant Press, Inc. v. Sealy*, 51 Cal. Rptr. 2d 365 (Cal. Ct. App. 1996).

19. See, e.g., *Shaffer v. Graybill*, 68 F.App’x 374, 377 (3d Cir. 2003) (“We are unaware of any relevant cases in which the court has found an adhesion contract when dealing with the purchase of a franchise . . . [W]e see no reason to view [franchisee] as anything but an experienced businessman who was free to reject the deal.”); see also *Jordan & Gitterman, supra* note 2, at 43–44 (survey of federal court jurisprudence).

20. See WILLISTON, *supra* note 15, § 32:12 n.9, which cites numerous state supreme and federal appellate courts for this proposition. See also RESTATEMENT (SECOND) OF CONTRACTS § 206(a) (1981) (*contra proferentem* is “often invoked in cases of standardized contracts and in cases where the drafting party has the stronger bargaining position”).

21. 619 N.E.2d 789, 795 (Ill. App. Ct. 1993). It is not clear whether the court intended to make ambiguity a condition precedent to *contra proferentem*, as is usually the case.

cases where the drafting party has the stronger bargaining position.”²² A number of federal and state appellate courts have refused to apply *contra proferentem* in the insurance context where the insurance policy was not adhesive, i.e., where the insured played a meaningful role in the negotiations.²³ Insurance cases may be relevant insofar as they delineate the types of evidence that may persuade a court to reject the adhesive label.

Second, the fact that a contract is adhesive will be relevant, although not dispositive,²⁴ to the court’s analysis of unconscionability, if that issue is raised by the franchisee. For example, in *Nagrampa v. Mailcoups Inc.*, the Ninth Circuit held that the adhesive nature of the franchise agreement effectively satisfied the procedural unconscionability prong of the two-part test for unconscionability under California law.²⁵ The Third Circuit made a similar finding outside the franchise context in *Alexander v. Anthony International, L.P.*, applying Virgin Islands law,²⁶ and the Ninth Circuit did likewise in the franchise case, *Ticknor v. Choice Hotels*, applying Montana law.²⁷ While there may be persuasive reasons to disagree with this analysis²⁸ and the precise contours of the test for unconscionability vary among U.S. states,²⁹ this case law nonetheless suggests that factual findings supporting the adhesive characterization may be relevant to the unconscionability analysis.³⁰

22. 429 F.2d 1197, 1206–07 (2d Cir. 1970) [internal quotations omitted]. See also *Victoria v. Super. Ct.*, 710 P.2d 833, 837 (Cal. 1985) (the adhesive nature of a contractual clause would support a “stricter construction” of ambiguities “against the party with the stronger bargaining position”).

23. See BARBARA O’DONNELL, LAW AND PRACTICE OF INSURANCE COVERAGE LITIGATION § 1:12 (June 2014) (available at Westlaw LPINLIT) (“Other courts strive for a middle ground by denying large, commercial insureds the benefits of *contra proferentem* only where the evidence establishes that they in fact . . . played some role in negotiating . . .”).

24. Caruso et al., *supra* note 5 (“rarely . . . sufficient to establish unconscionability”); Jordan & Gitterman, *supra* note 2, at 44–45 (discussing several cases that make this point clear).

25. 469 F.3d 1257, 1281–85 (9th Cir. 2009) (finding that procedural unconscionability was satisfied on the basis that “[franchisee] had overwhelming bargaining power, drafted the contract, and presented it to [franchisee] on a take-it-or-leave-it basis”); see also *Bridge Fund Capital Corp. v. Fastbucks Franchise Corp.*, 622 F.3d 996, 1004 (9th Cir. 2010) (finding that an absence of negotiation and inequality of bargaining power per se satisfy the procedural unconscionability prong); *Bolter v. Super. Ct.*, 104 Cal. Rptr. 2d 888, 893 (Cal. Ct. App. 2001) (finding that the adhesive nature of a contract per se satisfies the procedural prong of the two-prong analysis of unconscionability).

26. 341 F.3d 256, 265, 270 (3d Cir. 2003) (finding that procedural unconscionability “is generally satisfied if the agreement constitutes a contract of adhesion”).

27. *Ticknor v. Choice Hotels Int’l, Inc.*, 265 F.3d 931, 939–40 (9th Cir. 2001) (finding that a franchise agreement was adhesive on the basis that it was a “standardized, form agreement that [the franchisee] was forced to accept or reject without negotiation”).

28. Caruso et al., *supra* note 5 (emphasizing the mandatory delivery of a presale Franchise Disclosure Document as negating the “surprise” element typically present with adhesive contracts and procedural unconscionability); Jordan & Gitterman, *supra* note 2, at 41 (listing several factors that distinguish franchise agreements from typical contracts of adhesion).

29. For a criticism of the two-pronged approach to unconscionability, see *Alejandro v. L.S. Holding, Inc.*, 310 F. Supp. 2d 745, 749 n.3 (D.V.I. 2004).

30. WILLISTON ON CONTRACTS, *supra* note 15, § 18:10 (citations suggesting that many U.S. state and federal courts analyze procedural unconscionability by considering facts that would also be relevant to whether the contract is adhesive).

Third, in certain contexts, the bargaining position between the parties at the time of contract formation may be relevant to jurisdictional challenges based on public law grounds. In *Kubis & Perszyk Associates Inc. v. Sun Microsystems*, the New Jersey Supreme Court held that forum selection clauses in franchise agreements were presumptively unenforceable as contrary to public policy, unless the franchisor could offer “evidence of specific negotiations over the inclusion of the . . . clause . . . in exchange for specific concessions to the franchisee . . . [or] proof . . . that the . . . clause was not imposed on the franchisee against its will.”³¹ In *Burger King Corp. v. Rudzewicz*, the U.S. Supreme Court considered whether Florida’s arm’s-length jurisdiction statute violated the due process rights of Michigan franchisees, citing with approval lower court findings to the effect that the franchisee meaningfully negotiated the agreement and thus had fair notice of Florida jurisdiction.³² Other cases to similar effect have been analyzed elsewhere.³³

Fourth, a finding that a franchise agreement is adhesive may lead the court to apply a stricter level of scrutiny to any restrictive covenants found in the agreement, using the same analysis usually reserved for employment agreements. In *Watson v. Waffle House*, the Georgia Supreme Court held that a franchise relationship was analogous to an employment agreement for purposes of determining the level of judicial scrutiny to apply to a disputed restrictive covenant.³⁴ The court recognized that the case law dealing with the enforceability of restrictive covenants usually arises in the context of the sale of a business on the one hand, or cases involving employment relationships on the other. Since the level of judicial scrutiny—and thus the legal test for enforceability—was stricter in the employment context, the court needed to determine which test to apply to the franchise relationship in *Watson*. According to the court,

the rationale behind the [differential scrutiny] . . . is that a contract of employment . . . is often a contract of adhesion . . . [while] a contract for the sale of a business interest is far more likely [between] . . . parties on equal footing.³⁵

31. *Kubis & Perszyk Assocs., Inc. v. Sun Microsystems, Inc.*, 680 A.2d 618, 627 (N.J. 1996). This holding was distinguished in *Cohen v. Stratis Business Centers, Inc.*, 2005 WL 3008807 (D.N.J. 2005). Forum selection clauses in the United States will likely be analyzed in light of the decision by the Supreme Court in *Atlantic Marine Construction Co., Inc. v. U.S. District Court for Western District of Texas*, 134 S. Ct. 568 (2013).

32. 471 U.S. 462, 485 (1985) (“[franchisee] was represented by counsel throughout . . . [the] transactions and . . . conducted negotiations with [franchisor] over the terms of the franchise and lease agreements and . . . [was] able to secure a modest reduction in rent and other concessions . . .”).

33. See *Jordan & Gitterman*, *supra* note 2, at 16, 41–42 (fuller discussion of similar cases as well as the lower court decisions in *Burger King*).

34. *Watson v. Waffle House, Inc.* 324 S.E.2d 175, 177 (Ga. 1985) (“A lease agreement which bears the characteristics of a franchise creates a relationship in which the lessor possesses substantially superior bargaining power. It is for this reason that we adhere to our previous rule that such an agreement is analogous to an employment contract for purposes of analyzing the covenant not to compete”); *Atl. Bread Co. v. Lupton Smith*, 679 S.E.2d 722, 724 (Ga. 2009).

35. *Watson*, 324 S.E.2d at 177–78.

According to the court, since a franchise relationship is characterized by the “substantially superior bargaining power” of the franchisor, it is analogous to an employment contract “for purposes of analyzing the covenant not to compete.”³⁶ While this may be a minority and declining approach,³⁷ it has been followed in part by the Washington Court of Appeal, the Pennsylvania Supreme Court, and the Kansas Supreme Court.³⁸

Given these legal consequences that potentially flow from a finding that a franchise agreement is adhesive, it is important to consider the types of evidence that could defend such a characterization.

II. Consequences of Characterizing a Franchise Agreement as Adhesive in Canada

In Canada’s common law provinces (all but Quebec), the concept of contracts of adhesion developed most clearly in insurance litigation, with the Supreme Court of Canada and other appellate courts recognizing early on that such agreements were often imposed by the insurer on a “take it or leave it basis” and interpreting them *contra proferentem*.³⁹ As in the United States, leading Canadian treatises on contract law recognize that contracts of adhesion are more likely to be subject to interpretation *contra proferentem*,⁴⁰ likely because in such contexts the drafter is easy to identify. The Canadian common law approach has been influenced by English case law under which *contra proferentem* continues to resolve ambiguities against the drafter of

36. *Id.*

37. Peter J. Klarfeld & Mark S. VanderBroek, *Law on Covenants Against Competition Shifts Towards Greater Enforceability by Franchisors*, 31 *FRANCHISE L.J.* 76, 77 (2011) (“In recent years . . . courts increasingly have analogized covenants in franchise agreements to covenants in agreements for the sale of a business or have created a test for enforceability that is specific and favorable to franchising.”).

38. *Armstrong v. Taco Time Int’l*, 635 P.2d 1114, 1117 (Wash. Ct. App. 1981) (“Courts agree a franchise agreement is akin to an employment contract” for purposes of restrictive covenants.); *Piercing Pagoda, Inc. v. Hoffner*, 351 A.2d 207, 211–12 (Pa. 1976) (finding that the policy considerations underlying strict scrutiny of restrictive covenants in employment contracts are “equally important” to franchise agreements); *H&R Block, Inc. v. Lovelace*, 493 P.2d 205, 211–12 (Kan. 1972) (finding that the franchise agreement at issue was “more akin to [a contract] of employment than to a contract for sale or disposition of a business”).

39. *Zurich Life Insurance Co. of Canada v Davies*, [1981] 2 SCR 670, 674 (S.C.C.) (“ . . . there is every reason to apply a *contra proferentem* construction to a contract of adhesion such as we have here”); *Wagner Brothers Holdings Inc. v Laurier Life Insurance Co.* (1992), 56 O.A.C. 365, para 40 (Ont. C.A.) (“This was a contract of adhesion and, therefore, a *contra proferentem* construction is applicable.”), leave to SCC refused [1992] SCCA No. 455, [1993] 1 SCR vii (SCC); *Co-operators Life Insurance Co. v Gibbens*, 2009 SCC 59, para 25 (Can.) (“ . . . whoever holds the pen creates the ambiguity and must live with the consequences”).

40. JOHN McCAMUS, *THE LAW OF CONTRACT* 723 (2005) (“ . . . *contra proferentem* . . . is especially likely to be applied where the author of the document is in a stronger bargaining position than the other party and is able to deal on . . . a ‘take it or leave it’ basis”); GEOFF R. HALL, *CANADIAN CONTRACTUAL INTERPRETATION LAW* 186 (2d ed. 2012) (“In the case of a contract of adhesion, there is an increased propensity to apply the *contra proferentem* rule.”).

the contract.⁴¹ In Quebec, where the legal tradition can be traced to France (the birthplace of the phrase “*contracts d’adhesion*”), it is not surprising that the Quebec Civil Code expressly recognizes and provides for differential treatment to adhesive contracts.⁴² Indeed, as the discussion below illustrates, the Quebec courts have been particularly active in delineating the boundaries between adhesive and nonadhesive franchise agreements, likely because the issue is raised more regularly in franchise litigation in that province given the expressly differential treatment accorded to adhesive agreements under the Quebec Civil Code. All jurisdictions generally share a similar understanding that an adhesive contract is imposed on the weaker party on a “take it or leave it basis.”

Canadian courts have generally accepted that, by their nature, franchise and distribution agreements may be susceptible to being characterized as adhesive. In *Hillis Oil & Sales v Wynn’s Canada*, the Supreme Court of Canada held that a distribution agreement was adhesive on the basis that it was a standard form agreement drafted by the manufacturer and imposed on the distributor “with no opportunity to modify its wording.”⁴³ Similarly, in numerous other cases, appellate courts across Canada have accepted that franchise agreements may meet the requirements of adhesiveness.⁴⁴ Several English decisions, which continue to be persuasive in Canada, have also characterized franchise agreements as non-negotiated and standard-form.⁴⁵ Therefore, it is helpful to consider the potential implications of such a finding under Canadian law, of which there are four.

41. *Tam Wing Chuen v Bank of Credit and Commerce Hong Kong Ltd.*, (1996) 2 BCLC 69 (P.C) [77] (appeal taken from H.K.) (“... the basis of the *contra proferentem* principle is that a person who puts forward the wording of a proposed agreement may be assumed to have looked after his own interests, so that if the words leave room for doubt about whether he is intended to have a particular benefit there is reason to suppose that he is not”); *Association of British Travel Agents Ltd v British Airways plc*, [2000] 2 All ER (Comm) 204 (C.A.) [219–20] (U.K.); *Hawley v Luminar Leisure Ltd.*, [2006] EWCA Civ 18, [2006] IRLR 817 (C.A.) [100] (U.K.) (adopting the principle that “[i]n the case of ambiguity the construction which is more favourable to the insured should be adopted; this is the *contra proferentem* rule”).

42. The Civil Code defines a contract of adhesion as “a contract in which the essential stipulations were imposed or drawn up by one of the parties, on his behalf or upon his instructions, and were not negotiable. . . .” CIVIL CODE OF QUEBEC, S.Q. 1991, c. 64, art. 1379 (Can.); see generally Bruno Floriani & Marvin Liebman, *Exporting Your Franchise to Canada—Disclosure and Beyond*, 4:6 INT’L J. OF FRANCHISING LAW 15 (2008).

43. *Hillis Oil & Sales v Wynn’s Canada*, [1986] 1 S.C.R. 57, para 3, 17 (S.C.C.).

44. *Aamco Transmissions Inc. v Kunz*, (1991) 97 Sask.R. 5 (Sask. C.A.) (“This contract is one which was not in any true sense of the word negotiated, but is a franchise agreement proffered by a large corporation to a franchisee, who was not in an equal bargaining position.”); *Shelanu Inc. v Print Three Franchising Corp.* (2003), 172 O.A.C. 78, para 58 (Ont. C.A.) (“A franchise agreement is a type of contract of adhesion . . .”); *Proviso Distribution Inc. c. Supermarché A.R.G. Inc.*, [1997] Q.J. No. 3710, para 48 (Que. C.A.) (“... franchise contract . . . is sometimes also a contract of adhesion, because it contains standard clauses that are not open for negotiation”); *405341 Ontario Ltd. v Midas Canada Inc.*, 2010 ONCA 478, para 38 (Can.); *Salah v Timothy’s Coffees of the World Inc.*, 2010 ONCA 673, para 18 (Can.).

45. *Papa-Johns (GB) Ltd v Doyley*, [2012] All ER (D) 182, [2011] Lexis Citation 92, (Q.B.) [247] (U.K.); *Paperlight Ltd v Swinton Group Ltd*, [1998] C.L.C. 1667 (Q.B.) [1673] (U.K.).

First, as in the United States, the characterization of a contract as adhesive is more likely to result in it being interpreted *contra proferentem*.⁴⁶ In *Hillis*, the Supreme Court relied in part upon *contra proferentem* in finding that the distribution agreement did not authorize the distributor's termination.⁴⁷ Similarly, in *Salah v Timothy's Coffees of the World Inc.*, the Ontario Court of Appeal interpreted a franchise agreement *contra proferentem* to resolve any ambiguity regarding the scope of a renewal clause against the franchisor.⁴⁸ Under the Quebec Civil Code, moreover, *contra proferentem* is a mandatory tool for the interpretation of adhesive agreements.⁴⁹

Second, similar to the United States, if a Canadian court finds a franchise agreement to have been imposed on the franchisee on an effectively "take it or leave it basis," this may assist the franchisee to challenge a particular provision under the doctrine of unconscionability. In the nonfranchise case of *Birch v Union of Taxation Employees, Local 70030*, the Ontario Court of Appeal applied a two-pronged test for unconscionability, holding that the first prong, "inequality of bargaining power," was *per se* satisfied because the underlying contract was adhesive.⁵⁰ A leading treatise on Canadian contract law recognizes that the recent unconscionability cases consider the "twin criteria . . . [of] inequality of bargaining power . . . [and] inequality of exchange,"⁵¹ which are conceptually similar to procedural and substantive unconscionability, respectively, as applied in certain U.S. states. The Supreme Court of Canada has also observed that contracts of adhesion often give rise to challenges based on unconscionability.⁵² Under the Quebec Civil Code, similarly, courts have the jurisdiction to strike out any "abusive clauses" found in contracts of adhesion.⁵³

Third, if a franchise agreement is found to be a contract of adhesion, the courts may also be more inclined to review challenged restrictive covenants

46. See McCAMUS, *supra* note 40; HALL, *supra* note 40.

47. Hillis, *supra* note 43, at para 17.

48. Salah, *supra* note 44, at para 18.

49. HALL, *supra* note 40, at 187 (citing art. 1432 of the Civil Code of Quebec as "mandat[ing] the application of the *contra proferentem* rule to contracts of adhesion"); CIVIL CODE OF QUEBEC, S.Q. 1991, c. 64, art. 1432 (Can.) (" . . . In all cases, [a contract] is interpreted in favour of the adhering party . . .").

50. *Birch v Union of Taxation Employees, Local 70030*, 2008 ONCA 809, paras. 45, 49–51 (Can.) (Unconscionability requires "a finding of inequality of bargaining power and a finding that the terms of an agreement have a high degree of unfairness." Inequality of bargaining power was satisfied as the adhering parties took the agreement "as they found it with no ability to negotiate or change its term[s].").

51. S.M. WADDAMS, *THE LAW OF CONTRACTS* 397, 545 (6th ed. 2010).

52. See also *Domtar Inc. v ABB Inc.*, 2007 SCC 50, at para 82 (Can.), where the Supreme Court of Canada noted that "the doctrine of unconscionability . . . is generally applied in the context of a consumer contract or contract of adhesion."

53. CIVIL CODE OF QUEBEC, S.Q. 1991, c. 64, art. 1437 (Can.) ("An abusive clause in a . . . contract of adhesion is null, or the obligation arising from it may be reduced. . . . An abusive clause is a clause which is excessively and unreasonably detrimental to the . . . adhering party . . . in particular, a clause which so departs from the fundamental obligations arising from the rules normally governing the contract that it changes the nature of the contract . . .").

under the standard usually reserved for employment agreements.⁵⁴ The Supreme Court of Canada has explained that the higher scrutiny accorded to restrictive covenants in employment agreements flows from the “imbalance of bargaining power.”⁵⁵ In a recent employment decision, the Ontario Court of Appeal noted that the evidence in fact disclosed an inequality in bargaining power when the agreement was negotiated, distinguishing an earlier employment case where a more relaxed standard was applied on the basis that the employee “bargained as an equal.”⁵⁶ Similarly, the Supreme Court of Canada, recently applying the Quebec Civil Code, confirmed that evidence as to the bargaining position of the parties at the time the covenant was drafted, and whether they had independent legal advice, will affect the level of scrutiny to be applied to the question of enforceability.⁵⁷ These principles suggest that, in the franchise context, the level of scrutiny to be applied to a restrictive covenant may depend in part on whether the franchise agreement is truly a contract of adhesion.

Fourth, in Quebec, the characterization of a franchise agreement as adhesive may have implications for how the franchisor enforces covenants found outside the franchise agreement, for example, in the operating manual. This is because the Quebec Civil Code requires that “external clauses” be expressly brought to an adhering party’s attention in order to be enforceable.⁵⁸ Similarly, in a recent English decision that may be persuasive to Canadian courts, the English Court of Queen’s Bench refused to enforce an exclusion clause in a franchise agreement on the basis that the contract was a “standard document” imposed on a franchisee and that the clause “should have been brought to [the franchisee’s] attention” prior to the agreement being signed.⁵⁹

III. Resisting the Adhesive Characterization: Persuasive Evidence of Bargaining Power

Commentators have long recognized that the analysis supporting the adhesive characterization of a contract breaks down where the true author of the agreement is unclear,⁶⁰ where the traditionally understood “weaker

54. Jennifer Dolman, Adam Ship, Rebecca Hall-McGuire & Tyler Wentzell, *Governing Principles and Recent Trends in the Enforcement of Restrictive Covenants in Franchise Agreements*, 43:4 ADVOCATES’ Q. (Feb. 2015) (presented at the Ontario Bar Association’s Annual Franchise Law Conference in November 2014).

55. *Elsley v J.G. Collins Ins. Agencies*, [1978] 2 S.C.R. 916, 924 (Can.).

56. *H.L. Staebler Company Ltd. v Allan et al.*, 2008 ONCA 576, para. 56 (Can.).

57. *Payette v Guay inc.*, 2013 SCC 45, para. 39, 62 (Can.).

58. CIVIL CODE OF QUEBEC, S.Q. 1991, c. 64, art. 1335 (Can.). (“In a . . . contract of adhesion . . . an external clause is null if, at the time of formation of the contract, it was not expressly brought to the attention of the consumer or adhering party, unless the other party proves that the . . . adhering party otherwise knew of it.”).

59. *Papa-Johns*, *supra* note 42, at 247–50.

60. KIM LEWISON, *THE INTERPRETATION OF CONTRACTS* 363 (5th ed. 2011) (noting that the courts in England will examine which party truly introduced the disputed language into the agreement).

party” is actually economically sophisticated,⁶¹ and where there is actual evidence of negotiations over key covenants in the agreement.⁶² Indeed, in U.S. insurance litigation, where the adhesive label has been most prominent, a large body of “criticism about modern *contra proferentem* . . .” applies to “sophisticated, commercial insureds who are deemed well-informed about the terms and limitations of their policies.”⁶³ Similarly, there is a significant body of case law in both the United States and Canada where courts have taken a serious look at the evidentiary record to determine whether an insurance or franchise agreement is truly adhesive.

In an early decision of the Ontario Court of Appeal on this issue, the franchisor disputed the franchisee’s right to transfer its interest to a third party. In that case, the court emphasized that the franchisee held the largest number of units in the country (approximately 50 percent) and had exercised “very significant bargaining power in the negotiations which led to the [franchise] agreement.” On this basis, the court held that the franchise agreement was a “negotiated commercial document”⁶⁴ and declined to apply *contra proferentem*. This case suggests that, at a minimum, large, multiunit franchisees with true bargaining power should not be able to advance the adhesive characterization in litigation.

In some cases, the question of adhesiveness turned primarily on the fact that the underlying agreement had been the subject of changes at the franchisee’s behest⁶⁵ during the negotiation process. In a number of insurance disputes in the U.S. federal courts, the court, in rejecting the adhesive label, relied upon evidence that certain terms of the policy had been negotiated.⁶⁶ Although the insurance context may be distinguishable from franchising, these cases nonetheless shed light on the types of evidence that may per-

61. Caruso et al., *supra* note 5 (“Franchisors would be well served by introducing evidence . . . concerning the franchisees’ education and experience”).

62. *Id.* (“ . . . franchisees should be prepared to present evidence . . . that their efforts at negotiating the . . . franchise agreement were rebuffed . . .”).

63. See O’DONNELL, *supra* note 23, § 1:12.

64. *Kentucky Fried Chicken Canada v. Scott’s Food Services Inc.*, (1998) 114 O.A.C. 357, para. 6-7, 17, 27 (Ont. C.A.).

65. See *Ticknor v. Choice Hotels International, Inc.*, 265 F.3d 931, 939-40 (9th Cir. 2001), where the Ninth Circuit rejected the franchisor’s argument that the existence of amending agreements alone disproved adhesion because the franchisor imposed the addenda on a “take it or leave it” basis (relying on this finding to satisfy the test for procedural unconscionability under Montana law).

66. *Koch Eng’g Co., Inc. v. Gibraltar Cas. Co., Inc.*, 878 F. Supp. 1286, 1288 (E.D. Mo. 1995) (“[Insured] negotiated a complex, twenty million dollar policy [with the insurer] . . . called a manuscript policy, the mere title of which indicates that it was not an adhesion, preprinted contract but a policy negotiated by two equal parties on a level playing field”), *aff’d*, 78 F.3d 1291 (8th Cir. 1996); *Rouse Co. v. Fed. Ins. Co.*, 991 F. Supp. 460, 466 (D. Md. 1998) (“ . . . the record suggests that the policy was negotiated and drafted as a joint effort between two sophisticated business entities”); *Falmouth Nat. Bank v. Tigor Title Ins. Co.*, 920 F.2d 1058, 1062 (1st Cir. 1990) (“ . . . the sophistication of the [insured] and the fact that it negotiated specific terms of the policy lead us to believe that . . . interpreting ambiguities in favor of the insured does not apply with the same force . . .”); *Cooper Cos. v. Transcont’l Ins. Co.*, 37 Cal. Rptr. 2d 508, 512 (Cal. Ct. App. 1995).

suade a court to reject the adhesive label. For example, in *Falmouth National Bank v. Ticor Title Insurance Co.*, the First Circuit pointed to both the “sophistication of the [insured] and the fact that it negotiated specific terms of the policy.”⁶⁷ Similar factors were considered in an early franchise case in Quebec, where the Quebec Superior Court rejected a franchisee’s adhesive characterization on the basis that she carefully reviewed the agreement, obtained independent legal advice prior to signing, and secured numerous amendments both by crossing out selected provisions and making certain additions.⁶⁸

In another line of cases, courts have been prepared to reject the adhesive characterization based on evidence that the franchisee could have negotiated the provisions even though it never availed itself of that opportunity. In this regard, a common approach in the Quebec case law is for courts to focus on whether the franchisee attempted to exercise due diligence in the transaction, with numerous courts refusing to characterize the agreement as adhesive where the franchisee failed to take any reasonable steps to protect its own interests.⁶⁹ In *Entreprises Mty Tiki Ming Inc. c. McDuff*, the Quebec Superior Court held that in order for a franchise agreement to be adhesive, there must be evidence both that the franchisor drafted the essential terms and that it was impossible for the franchisee to negotiate.⁷⁰ According to the court, the requirement of impossibility recognizes that franchisees owe themselves a duty to protect their own business interests, which includes pursuing opportunities to negotiate.⁷¹ On the facts, the court refused to find a contract of adhesion on the basis that the franchisee rushed to sign the agreement for her own reasons and failed to inform herself or to make reasonable inquiries of the franchisor.⁷² In another Quebec decision, the court again rejected the adhesive label on the basis that it would have been possible for the franchisee to negotiate changes had an attempt been made.⁷³ Applying a similar analysis in an insurance case, the U.S. District Court for the Southern District of New York in *Ethicon Inc. v. Aetna Casualty and Surety Co.* refused to charac-

67. *Falmouth*, 920 F.2d at 1062.

68. *Voncorp Inc. c. 147013 Canada Inc.*, 1997 CarswellQue 4232, para. 60-62 (Que. S.C.).

69. *Michael Publishing Company Inc. (Suburban) c. Holand Chrysler Dodge Jeep ltee.*, 2014 QCCQ 427, para. 28-33 (Can.) (finding that it would have been possible for the franchisee to negotiate the terms of the agreement); *9069-7384 Quebec Inc. c. Superclub Videotron ltee.*, [2004] R.J.Q. 892, para. 103-105 (Que. S.C.) (court pointing to the fact that franchisee declined to seek independent legal advice when encouraged by the franchisor and refusing to find an impossibility for negotiation); *Distribution Stereo Plus inc. c. 140 Greber Holdings*, 2012 QCCS 33, para. 37-48 (Can.) (emphasizing the franchisee’s “failure to attempt negotiation”); *Asselin c. Groupe pétrolier Olco ULC inc.*, 2014 QCCQ 2733, para. 51-56 (Can.) (insufficient evidence that the franchisee could not freely negotiate the terms of the agreement).

70. *Entreprises MTY Tiki Ming Inc. c. McDuff*, 2008 QCCS 4898, para. 189, 198, 202, 205 (Can.). This test was also applied in *Michael Publishing*, *supra* note 69, at para. 28.

71. *Id.* at para. 208-14.

72. *Id.* at para. 216-20.

73. *Michael Publishing*, *supra* note 69, at para. 28-33 (finding on the basis of the evidence of one witness that it was possible to negotiate the terms of the agreement)

terize an insurance policy as adhesive on the basis that the insured had the market power to negotiate changes, even though it elected not to do so.⁷⁴

These cases should provide a note of caution to franchisees who assert that their franchise agreements are adhesive in subsequent litigation even though they never bothered to attempt negotiation or to exercise diligence during the initial transaction. However, in the end, every case will turn on its own facts. In an early insurance case, the Second Circuit recognized nuances in the factual record and labelled an insurance policy adhesive even though the insured was a large, sophisticated corporation that had the ability to negotiate certain terms of the policy. The primary factors for the court were that the key provisions of the policy relating to insurance coverage were untouchable during the negotiations and that the insured was bargaining with a consortium of insurers that effectively controlled the entire market for the type of insurance at issue, leaving the insured with nowhere else to turn.⁷⁵ This suggests that where there is no meaningful substitute for the adhering party for the product at issue, the court may find a lack of bargaining power despite the size and experience of the adhering party and the fact that subsidiary clauses were amended.

Another important factor that has persuaded the courts to reject the adhesive label relates to the role of franchisee associations in the negotiation of the franchise agreement. The Quebec Court of Appeal addressed this issue in the context of a franchisee encroachment claim brought against its franchisor.⁷⁶ One of the issues was whether a clause in the franchise agreement that potentially assisted the franchisor was abusive, i.e., unconscionable, within the meaning of the Quebec Civil Code, which required a finding that the agreement, among other things, was adhesive. In examining this issue, the court considered evidence regarding the role of the franchisee association that had negotiated with the franchisor over the version of the franchise agreement at issue. The court relied on this evidence in declining to label the franchise agreement as adhesive, pointing to a number of factors, including intensive negotiations with the association over the precise term at issue in the case.⁷⁷ The court also noted that this particular association

74. *Ethicon, Inc. v. Aetna Cas. & Sur. Co.*, 737 F. Supp. 1320, 1327 (S.D.N.Y. 1990) (“The fact that . . . no negotiations actually took place over the details of the terms of the insurance policies at issue . . . has no bearing . . . [as the insured] had the market power to negotiate with its insurers on an even field. The fact that it chose not to do so will not affect that Court’s determination. . . . [The insured] was fully capable of negotiating for terms which it felt to be important for its insurance coverage.”).

75. *Pan Am. World Airways Inc. v. Aetna Cas. & Sur. Co.*, 505 F.2d 989, 1003 (2d Cir. 1974) (“The . . . insurers are in effect all of the underwriters in the world who write such [all-risk] insurance. [The insured] had no place else to turn for all risk coverage. The types of risks to be excluded by the . . . policies may have been negotiable . . . but the words describing these risks were not open to negotiation. These words were offered to the insured on a take-it-or-leave-it basis.”) The Second Circuit further explained this in *Schering Corp. v. Home Insurance Co.*, 712 F.2d 4, 10 n.2 (2d Cir. 1983).

76. *Martineau c. Societe Canadian Tire ltee*, 2011 QCCA 2198 (Can.).

77. *Id.* at para. 35–37.

was independent, well established, and reputable, pointing to the fact that its board of directors was made up of franchisees and that two association representatives were actually members of the franchisor's board of directors.⁷⁸ In the end, the court found the franchise agreement to have been freely negotiated.⁷⁹ While the result in this case may in part be explained by the unusual clout enjoyed by this particular franchisee association,⁸⁰ the court was arguably persuaded by the fact that the franchisor had engaged in meaningful negotiations over the form of franchise agreement.⁸¹ This legal result may provide an incentive to other franchisors to pursue such negotiations in the future.

IV. Conclusion

At a minimum, courts should be prepared to review the evidentiary record closely before labelling a franchise agreement as adhesive. Where franchisees are economically sophisticated relative to the franchisor and where actual changes have been made to the franchise agreement at the franchisee's request, persuasive authority supports the proposition that the agreement is anything but adhesive. Other courts, particularly in Quebec, have been prepared to go further, emphasizing the duty of franchisees to exercise due diligence and requiring evidence that the franchisees actually attempt to negotiate. Although the differential approach by the courts to this issue makes clear that every case must turn on its own facts,⁸² franchise litigators should be prepared to consider introducing evidence on this issue in any dispute where the adhesive label is at risk of being imposed.⁸³

78. *Id.* at para. 34.

79. *Id.* at para 44.

80. See Emerson & Benoliel, *supra* note 10 (noting that many franchisors refuse to even negotiate with associations).

81. See *supra* note 12 (Canadian courts have not to date recognized a positive obligation on franchisors to negotiate with franchisee associations).

82. See *Bolter v. Super. Ct.*, 104 Cal. Rptr. 2d 888, 893 (Cal. Ct. App. 2001) (where a franchisee in a preexisting relationship with the franchisor was found to have been under significant pressure to accept the franchise agreement without amendment); see also Caruso et al., *supra* note 5 (citing cases that suggest "that a renewing franchisee might potentially fare better than a new franchisee on the issue of procedural unconscionability").

83. See generally Caruso et al., *supra* note 5, for a discussion of the strategic use of evidence in unconscionability cases.

