

Structuring royalties on professional fees

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Introduction

In Canada, as in many other jurisdictions, certain acts are reserved solely to members of professional orders. For example, prescribing medications and determining medical treatments are activities restricted to physicians.⁽¹⁾ In the case of pharmacists, selling and dispensing medications are strictly reserved acts.⁽²⁾

To ensure that professionals who perform reserved acts, as well as their businesses, maintain professional independence and remain subject to the authority of their respective professional orders, the sharing of professional fees with non-professionals is largely prohibited.

In the context of franchising, the payment of royalties by professional franchisees to their franchisors has often been considered to be a form of profit sharing relating to revenues generated from certain reserved acts. However, courts in Quebec have recently established the validity of payments calculated on the basis of professional revenues, specifically in the case of pharmacists.

Background

In Canada, pharmacists are prohibited from sharing with non-pharmacists the profits generated from the sale of medications or otherwise from the sale of products or services reserved to the pharmacist profession (ie, professional revenue).⁽³⁾ This prohibition is intended to:

- reserve to pharmacists the right to practise pharmacy; and
- prevent non-pharmacists from controlling, operating or having undue influence on a pharmacist or his or her business, failing which the pharmacist may fall outside the purview of the relevant professional order, potentially endangering the public.⁽⁴⁾

The prohibition on profit sharing does not, in principle, preclude pharmacists from entering into franchise agreements with non-pharmacists and paying royalties on revenue that does not constitute professional revenue. However, until recently, there was significant doubt as to the validity of fees payable by professional franchisees on the basis of professional revenue. Two decisions in Quebec have established certain conditions for such fee payments to be considered valid, in particular that the fees are related to the fair market value of the goods or services provided to the professional.

Decisions

Cadrin v Pharmaciens

In *Cadrin v Pharmaciens (Ordre professionnel des)*⁽⁵⁾ the Quebec Professional Tribunal invalidated the Disciplinary Council of the Order of Pharmacists of Quebec decision which had found two pharmacists guilty of sharing in the profits from professional revenue with a management company which was not entirely controlled by pharmacists. In this case, the pharmacists paid the management company rent which was calculated based on a percentage of their sales revenue,

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without distinction as to professional revenue. The Disciplinary Counsel of the Order of Pharmacists calculated the fair market value of the surface area occupied by the pharmacy to determine whether the pharmacists were overpaying for their rent, and found that the pharmacists' rent exceeded the fair market value of the leased premises. It therefore concluded that the pharmacists were illegally sharing their profits with the management company. However, the Quebec Professional Tribunal concluded that the pharmacists' payment of rent to the management company was valid given that it considered that the fair market value of the rent could not be based solely on the surface area actually occupied by the pharmacy, and should include other areas necessary to the pharmacy's operations (eg, the common areas, a post office and a storage area). The tribunal determined that the rent paid by the pharmacists did not exceed the fair market value of the goods and services provided by the management company, namely the leased premises which included but was not limited to the area occupied by the pharmacy. As such, the rent paid could not be considered illegal profit sharing, even though it was calculated on the basis of professional revenue, which was found to be a legitimate basis of calculation.

Quesnel v Groupe Jean Coutu

In *Quesnel v Groupe Jean Coutu (PJC) inc*(6) the Quebec Superior Court dismissed another Disciplinary Council of the Order of Pharmacists of Quebec decision, which had found a pharmacist guilty of sharing profits from professional revenue. In this case, the pharmacist had been paying a royalty fee to a franchisor based on a percentage of gross sales – which included professional revenue – in exchange for goods and services provided by the franchisor. The court found that using the revenues generated from the sale of medications and other professional acts to pay for the pharmacy's business expenses did not violate the prohibition on profit sharing, including where such expenses constituted fees for the licences and services received by the pharmacist. The court concluded that a literal interpretation of the profit sharing prohibition provided in the Code of Ethics of Pharmacists would be absurd, as it would prevent pharmacists from using the monies generated by their business in the ordinary course to pay for expenses related to the business and the products and services essential to its operations.

Comment

In the wake of these decisions, it is clear that fees payable by pharmacists to franchisors and other third parties must be paid in exchange for goods and services provided to the pharmacist assessed at their fair market value. Such fees cannot be based solely on professional revenue without the pharmacist receiving anything in return. However, where the royalties paid by a pharmacist to his or her franchisor in exchange for the use of a trademark are greater than their fair market value, the courts could conclude that the portion of the royalty that is in excess of the fair market value is invalid and may constitute illegal profit sharing by the pharmacist.(7) Further, it is essential that pharmacists maintain professional independence with respect to all reserved acts, and that any royalties or other fees payable are not construed so as to limit the professional's independence at the risk of being considered illegal.(8)

The foregoing decisions confirm that pharmacists in Quebec may be franchisees under franchise agreements that include royalty clauses expressly contemplating the payment of fees to the franchisor on the basis of a percentage of the professional revenue, provided that such royalty is paid in exchange for goods and services actually provided by the franchisor, at fair market value. However, the royalty must not constitute profit sharing in respect of the pharmacist's income.

The principles established in these decisions are likely to find application more generally in the context of many other franchised businesses involving professionals that require the payment of royalties or other fees on the basis of their professional revenues. As such, franchisors should be careful to require the payment of royalties and other fees solely in respect of *bona fide* goods and services provided to professional franchisees, and should take steps to ensure that any royalties and fees calculated on the basis of professional revenue are truly reflective of the fair market value of the goods and services provided in return.

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Endnotes

- (1) Section 31 of the Medical Act, c M-9.
- (2) Sections 17 and 27 of the Pharmacy Act, c P-10.
- (3) Section 49 of the Code of Ethics of Pharmacists, CQLR c P-10, r 7.
- (4) *Cadrin v Pharmaciens (Ordre professionnel des)*, 2015 QCTP 104 at para 29.
- (5) *Ibid.*
- (6) 2016 QCCS 6347.
- (7) *Pharmaciens (Ordre professionnel des) v Lévesque*, 2007 CanLII 81616 (QC CDOPQ) at para 13.
- (8) *Quesnel v Groupe Jean Coutu (PJC) inc*, *supra* note 6 at para 79; *Cadrin v Pharmaciens (Ordre professionnel des)*, *supra* note 4 at para 29.

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