FRANCHISE AND DISTRIBUTION JOURNAL

Arthur Wishart Act (Franchise Disclosure), 2000: Recommendations for Amendment:

Joseph Adler, Davis & Company (Toronto)

PART 1: ONTARIO ACT

Close to four years have passed since the enactment of the **Arthur Wishart Act (Franchise Disclosure), 2000** (the "Act") and the regulations thereto (the "Regulations"). Given the passage of time and the collective experience of franchise counsel to date, it is instructive to review the Act and Regulations and to reflect upon some of the issues arising from this legislation since its inception. In particular, franchise counsel have attempted to grapple with several serious technical and substantive concerns and deficiencies in the wording of the Act and Regulations. While some issues have been raised in public forums and in certain publications over the past four years, there has been no comprehensive analysis of the Act and Regulations designed specifically for this purpose to date. This article is a humble attempt to provide that analysis and to respectfully propose some recommendations for amendment of the Act and the Regulations[1].

It could be said that the Act and Regulations have been fairly successful in their attempt to strike a balance between the often competing interests of the franchisor and those of the franchisee. In drafting the legislation that ultimately became the Act and Regulations, the legislators were clearly and ultimately concerned with protecting prospective and existing franchisees. The thrust of this legislation is and continues to be the disclosure obligations imposed upon franchisors when selling franchises to prospective franchisees. As well, there is a sprinkling of relationship laws that are designed to impose certain obligations upon franchisors and to otherwise extend certain rights to franchisees. The Act and Regulations largely manage, despite the existing deficiencies, to ensure that franchisors are not overly burdened from a compliance point of view.

Notwithstanding its merits and successes to date, Ontario's franchise legislation would certainly benefit from a comprehensive review and some revision to address some or all of the issues identified in this paper.[2] The occasional grammatical error can be easily addressed by way of a simple and non-contentious amending Regulation. Various omissions, ambiguities and inconsistencies may be rectified by Regulation, as well, provided that the amending Regulation is preceded, of course, by further discussion, analysis and debate by various interested parties.

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[1] This paper was recently submitted to the Ontario Bar Association's Joint Sub-committee on Franchising with respect to its submissions to the Government of Ontario for suggested amendments to the Act and the Regulations.

[2] It is important to note in this regard the concurrent efforts to address the formulation and development of franchising legislation in general at each of the national and international levels and its potential impact on the existing franchise legislation in the Provinces of Ontario and Alberta. In Canada, the Commercial Law Strategy of the Uniform Law Conference of Canada established a working group in May, 2002 to develop uniform franchise legislation for the possible adoption and use of any interested Provinces across Canada. Internationally, the International Institute for the Unification of Private Law (UNIDROIT) proposed the Model Franchise Disclosure Law in September, 2002, which adopted the work of the UNIDROIT Study Group on Franchising. Each of these initiatives should be carefully examined in conjunction with this paper's attempt to address and rectify the deficiencies in the Ontario legislation as outlined in this paper.

It is not intended that this paper identify all of the possible issues arising out of an analysis of the Act and Regulations, as it would be impossible to conceive of or to anticipate all such issues at this time. This writer's objectives will have been satisfactorily met, however, if further discussion and debate is stimulated as a result of this paper.

Finally, certain technical and substantive amendments to the Act and to the Regulations are proposed herein to help facilitate compliance with this legislation and to bring greater clarity to franchise practitioners, and to prospective and existing franchisors and franchisees. By addressing these issues, we are hopeful that franchisors and franchisees alike will gain a clearer understanding of their respective rights and obligations.

THE ONTARIO ACT

1. Section 1 - Definitions

(a) In determining whether the Act will apply to any given relationship, one must first examine the definition of a "franchise" (along with the exemptions set out at Sections 2(3) and 5(7) of the Act). If the subject party is not granting a "franchise" as such term is defined by the Act, a "franchise agreement" will not have been entered into by the parties and the "franchisor" and "franchisee" definitions will similarly not have been met, thereby placing the relationship completely and safely outside the scope of the Act and the Regulations. As such, the definition of a "franchise" is critical in assisting us to determine whether the Act is applicable.

The definition of a "franchise" contains a reference to two different forms of franchising: one commonly referred to as "business format" franchising and the other, "distribution format" franchising. If either of these definitions is satisfied and, as well, a payment or continuing payment is made to the franchisor or its associate, then the Act will consider the business relationship to be a "franchise".

Issue: The primary regulatory intent underlying the Act and the Regulations is to protect prospective and existing franchisees from their franchisors. We can assume, however, that the Act was not designed to regulate wholesale merchandising where an arrangement is entered into to simply distribute product or services (and the distributor is required to purchase inventory or services intended for resale) and where the purchases are made at bona fide wholesale prices. Such a scenario should not be deemed to be a "franchise" under the Act, notwithstanding the imposition of certain controls by the manufacturer over the distributor, for example, or the presence of a trade-mark licensing arrangement as between the parties. **Recommendations:** The Ontario Act should specifically adopt language similar to that found in the Alberta *Franchises Act*[3] (the "Alberta Act") which essentially exempts any payment made by a party to another that is in respect of a purchase of or an agreement to purchase a reasonable amount of goods or services at a reasonable bona fide wholesale price.

[3] See Sections 1(1)(f)(i.) and (ii.) of the Alberta Act. The Federal Trade Commission (FTC) adopted a similar policy in its Final Interpretative Guides to the FTC Franchise Rule. In particular, the Commission excludes from its "required payment" component of its definition of a "franchise" under the FTC Franchise Rule, any "payment made by a person at a bona fide wholesale price for reasonable amounts of merchandise to be used for resale". The Model Law proposed by UNIDROIT similarly exempts such payments (See Article 2 of the Model Law).

In addition, the words "continuing payments" in this definition seem superfluous as one payment alone, rather than two or more and whether or not such payments are continuing, would suffice to meet this part of the definition.

Issue: To satisfy the business format definition of a "franchise", the grant by the franchisor to the franchisee must be for goods or services that are substantially associated with the trade-marks of the franchisor or its associate. Accordingly, this definition will only be satisfied if the franchisor or any of its associates actually owns the said trade-mark or other intellectual property right. It is quite conceivable, however, that a franchisor may simply be a licensee of such rights from an unrelated third party licensor, with a right to sub-license to its franchisees. In such event, the third party licensor would not be deemed to be an "associate" of the franchisor as it does not exert the control required to meet that definition. As such, the arrangement would not constitute a "franchise" under the Act and a prospective franchisee would not be entitled to receive a disclosure document. **Recommendation:** This section of the Act should be amended to include any grant of a right to sell or distribute goods or services that are substantially associated with not only the franchisor's, and the franchisor's associate's, trade-mark, service mark, trade name, logo or advertising or other commercial symbol, but also any such property right licensed to the franchisor or the franchisor's associate by any third party.

(b) **Issue:** The definition of "material change" and "material fact" both define materiality in terms of information concerning the business, operation, capital or control of the franchisor (or its associate) or a change in the franchise system that would reasonably be expected to have some sort of effect on the value or price of the franchise or the decision to purchase the franchise. Though some franchise practitioners have argued that there is as well a statutory obligation to disclose material facts pertaining to the franchise to be purchased, the said definitions refer solely to the affairs of the franchisor (and its associates) and the system and do not explicitly require disclosure regarding the franchise itself. Such information, however, is often material and should be disclosed to a prospective franchisee. **Recommendation:** The words "or the franchise to be granted" should be added to both definitions following the words "the franchise system".

(c) **Issue:** The definition "prospective franchisee" includes any person who is invited by a franchisor (or its associate, agent or broker) to execute, or who has indicated an interest to enter into, a "franchise agreement". The definition of a "franchise agreement" is rather broad and includes any agreement that relates to a franchise between a franchisor or its associate and a franchisee. The definition of "prospective franchisee", therefore, is sufficiently expansive to inadvertently encompass a third party such as a guarantor of the franchisee. Where such a guarantor is invited to execute a guarantee or any other agreement that relates to the franchise being offered to the franchisee, therefore, a guarantor could be deemed as being a "prospective franchisee", thereby triggering the disclosure obligations under the Act with respect to that guarantor. As guarantors are occasionally introduced to the franchisor only after the franchisee has executed his/her franchise agreement and a company is incorporated on behalf of the franchisee, a franchisor would then be required to once again provide disclosure, this time to the guarantor. **Recommendation:** The definition "prospective franchisee" should specifically exclude any guarantor or like person who is not the party directly purchasing the franchise from the franchisor.

(d) **Issue:** As noted above, the definition of "franchise agreement" is a rather expansive one as it includes "any agreement that relates to a franchise between a franchisor or franchisor's associate and a franchisee". The definition of a "franchise agreement" would include a confidentiality agreement, for instance, along with other agreements that might be entered into by the franchisor with a prospective franchisee prior to granting a franchise to the said prospective franchisee. The prospective franchisee, therefore, would be entitled to receive a disclosure document from the franchisor at least 14-days prior to executing any such confidentiality agreement, thereby significantly reducing the usefulness of a confidentiality agreement. The franchisor, on the other hand, currently has no choice but to make disclosure to the prospective franchisee without receiving in return any covenant on the part of the said franchisee to maintain the information in confidence. In the absence of a confidentiality agreement, such disclosure may expose the franchisor to significant risk as its confidential information would be revealed without the benefit of any assurances from the prospective franchisee that the information will be received in confidence. **Recommendation:** The definition of a "franchise agreement" should specifically exclude a confidentiality agreement provided that no payment is required to be made by a franchisee to a franchisor or a franchisor's associate in consideration of being required to enter into the confidentiality agreement.[4]

(e) **Issues:** The definitions of "material change" and "material fact" are internally inconsistent. Whereas the definition of "material change" refers to a "significant adverse effect", "material fact" speaks of a "significant effect". Were these terms deliberately differentiated in the manner set out above or is it simply a matter of careless legislative drafting? One could argue that the definition of a "material change" should include a significant change, whether or not the change had an *adverse* impact on the price or value of the franchise or the franchisee's decision to acquire the franchise.[5] **Recommendation:** The word "adverse" is an unnecessary qualifier and should therefore be deleted from this definition. Prospective franchisees should be made aware of any positive developments that would impact the value or price of the franchise or its decision to purchase the franchise, as well as any adverse changes. If full disclosure is the

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[4] The Franchise Association of Southern Africa's Code of Ethics and Business Practices, for example, provides that the "franchisor may require the prospective franchisee to sign a statement acknowledging the confidentiality of the information relating to the franchise or to the franchisor", without necessarily triggering the disclosure obligations under the Code. While not having the force of legislation, members of the Franchise Association of Southern Africa are required to abide by the Code of Ethics and Business Practices. UNIDROIT'S Model Franchise Disclosure Law similarly exempts "agreements relating to confidentiality of information delivered or to be delivered by the franchisor" and goes even further by excepting a "security (bond or deposit) given on the conclusion of a confidentiality agreement" from the payment component of the 14 day disclosure rule.

[5] Note also the parallels and differences between the definition of "material change" in the Act and that of the definition of the identical term at Section 1(1) of the Securities Act. For the most part, the definitions are identical, though the Act uses the word "adverse" to modify the threshold that is required to amount to a "material change" (i.e., "significant adverse effect on the value or price of the franchise"). In other words, the Securities Act may consider something to amount to a "material change" even where the change had a significant *positive* effect on the market price or value, whereas the Act in its current state is only concerned about significant *adverse* effects on the price or the value of the franchise.

standard to which the Act is attempting to establish and require, then prospective franchisees should be made aware of any such changes, whether positive or adverse.[6]

2. **Section 2 - Application**

Issue: Section 2(3) of the Act identifies certain commercial relationships or arrangements that are specifically exempted from the application of the Act. Should the Act not apply, however, in those kinds of relationships or arrangements even where the relationship or arrangement exhibits all of the features of a franchise under the Act? While the burden of proof is on the party relying upon the exemption or exclusion (Section 12 of the Act), a franchisor could nonetheless avoid the application of the Act by framing the relationship so that it falls under one of the exclusions under Section 2(3) of the Act. Some of the exclusions provided for in Section 2(3) should in any event be exempted from the Act (e.g., employer-employee and partnership relationships) whether or not they otherwise constitute a franchise, as these relationships are either governed by other existing legislation or the common law or the particular situation does not require the protections afforded by the Act. The arrangements provided for at Sections 2(3)5. through to 8., however, could be established to deliberately circumvent the Act. Furthermore, it is curious as to why each of the single license (Section 2(3)5.), the retail lease (Section 2(3)6.), oral agreement (Section 2(3)7.) and the Government arrangement (Section 2(3)8.) exemptions were included to begin with, particularly in those circumstances where such arrangements otherwise meet the definition of a "franchise" under the Act. **Recommendation:** The Act should be amended to delete altogether those arrangements provided for at Sections 2(3)5. through to 2(3)8.

3. **Section 4(4) – Right to Associate**

Issue: Section 4(4) refers to "any provision in a franchise agreement **or other agreement relating to a franchise**" [Emphasis added]. The highlighted wording is superfluous as the words "franchise agreement" is already broadly defined as including any agreement relating to a franchise between the franchisor and the franchisee. A similar problem exists with the wording at Sections 5(1)(a), 5(4)(c) and 5(5)(a). **Recommendation:** The highlighted words noted above and any variations thereof should be deleted wherever referenced in the Act to avoid any ambiguity and to tighten up the language of these sections.

4. **Section 5 - Franchisor's Obligation to Disclose**

(a) **Issue:** Section 5(b) prohibits a franchisor from receiving any consideration from a prospective franchisee before the 14-day cooling off period has expired. Should a refundable deposit made by the prospective franchisee with the franchisor or its associate be specifically excluded from this prohibition? **Recommendations:** Such a deposit could give the franchisor some comfort that it is dealing with a serious prospect who is worthy of receiving disclosure of its valuable and confidential information. At the same time, a prospective

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[6] On the other hand, it could be argued that if a change had a positive impact insofar as it had significantly increased the value or price of the franchise, then a franchisee should not be able to avail itself of any remedy under the Act in this regard and that the word "adverse", therefore, should not be removed from this Section. A satisfied franchisee, however, is less likely to commence an action against its franchisor on the grounds that it received a more valuable franchise. In any event, the definitions of "material change" and "material fact" should be consistent.

franchisee will not necessarily be prejudiced if it can be assured that the franchisor is required to return the deposit at the expiry of the 14-day period should it decide not to purchase the franchise. Section 5(1)(b) should therefore be amended by excluding any refundable deposits made by prospective franchisees from this prohibition.

(b) **Issue:** What if a prospective franchisee were to make a payment not to the franchisor nor to its associates, but to some third party (e.g., a landlord) in respect to the franchise to be purchased? Section 5(b) as currently drafted would not capture such a payment and would therefore not protect a prospective franchisee. **Recommendation:** Section 5(1)(b) should be amended by adding the words "or to any third parties in respect of the franchise" following the words "the franchisor or franchisor's associate".

(c) **Issue:** Section 5(2) permits the delivery of disclosure documents by way of personal delivery, registered mail or "by other prescribed method". Currently, there are no regulations that have addressed the issue of delivery, so franchisors are restricted to the aforesaid two rather limited forms of making disclosure. As some disclosure documents are voluminous, some franchisors have found it impossible to deliver their disclosure documents by registered mail due to Canada Post's size and weight restrictions for registered mail deliveries. Further, nowhere does the Act require that the disclosure document be set out in writing, though that may be implied by virtue of the requirement in Section 5(2).[7] Finally, the franchisor should be permitted to provide disclosure by way of a video cassette or computer diskette. **Recommendation:** A Regulation should be passed to permit franchisors to deliver their disclosure documents by video, cassette or computer diskette (or by other electronic means) and/or by courier. As long as the document meets the requirement set out at Section 5(6), i.e., that the document be "accurately, clearly and concisely set out"[8], the prospective franchisee will not be prejudiced by these methods of delivery.[9]

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[7] This problem is underscored by the fact that the statement of material change (Section 5(5)) specifically requires that a "written statement" be provided to a prospective franchisee and that Section 5(2) is permissive in its tone ("may") and not prescriptive ("shall"). Also, it is interesting to note that UNIDROIT's Model Law does require that disclosure be in writing.

[8] It is also interesting to note that Section 5(3) requires that a disclosure document be delivered as one document, delivered at one time and that it be comprised of one document. This Section would therefore seem to preclude the franchisor's ability to incorporate by reference any document that is outside the four corners of the disclosure document, including, a reference to an operations manual, a common feature of most disclosure documents.

[9] The Federal Trade Commission issued an Informal Staff Advisory Opinion (#97-2, CCH Business Franchise Guide ¶6482), whereby the FTC considered the acceptability of delivery of UFOCs via computer diskettes and concluded that it would satisfy the US Franchise Rule provided that: (a) the prospective franchisee agrees to accept delivery in that manner; (b) the franchisor discloses the computer system and word processing application used to create the electronic version; (c) the prospective franchisee is granted the option to obtain a hard copy within a reasonable time of receiving the electronic version (in case the franchisee cannot read the said version); (d) the computer diskette adequately draws the attention of the prospective franchisee to the significance of the information contained in the diskette; and (e) each diskette states its chronological number and the total number of diskettes. In Australia, the Franchise Code of Conduct contains a special note at the end of clause 10 of the Code which specifically permits the electronic delivery of disclosure documents. This note recognises that under subsection 9(1) of the *Electronic Transactions Act 1999* (Australia), a requirement under a law of the Commonwealth to give information in writing is satisfied by giving the information electronically if it is reasonable to expect that the information will be readily accessible and useable for subsequent reference, and the person receiving the information consents to the information being provided electronically.

(d) **Other Disclosure Issues:**

Issue: Section 5(4)(c) requires that a disclosure document contain copies of "all proposed franchise agreements and other agreements relating to the franchise to be signed by the prospective franchisee" to the prospective franchisee. There is a substantial amount of overlap between i. the material information required to be disclosed by the Regulations and ii. the information which Section 5(4)(c) requires to be disclosed. This apparent duplication creates confusion and potentially violates the "accurate, clear and concise" rule set out at Section 5(6) of the Act. **Recommendation:** As with Article 5(2) of the Model Law, the Act and Regulations should be amended to specifically exempt the disclosure of information that is already contained in the franchise agreement and other agreements, provided that a simple reference is made in the disclosure document to the relevant sections of those agreements.

Issue: It is a commonly held view that the disclosure obligations under the Act are solely designed to protect parties who have not yet entered into a franchise agreement with their franchisors and that there is no post-sale disclosure obligation imposed upon franchisors once a franchise agreement is executed by the parties. This view is called into question given the extremely broad definitions of "franchise agreement" and "prospective franchisee". If a re-disclosure obligation exists, therefore, an existing franchisee who during the currency of its franchise agreement is required by its franchisor to execute a wholly new agreement, such as an addendum to the franchise agreement, is entitled to receive an up-to-date disclosure document at least 14 days prior to the date that the agreement is to be executed, provided of course that no exemptions under Section 5(7) are available[10]. This franchisee would also be entitled to a two year period in which to claim rescission if the franchisor failed to provide disclosure altogether.

The disclosure obligation under Section 5 requires disclosure by a franchisor to a "prospective franchisee", which, is broadly defined as including anyone "who has indicated, directly or indirectly, to a franchisor or a franchisor's associate, agent or broker an interest in entering into a franchise agreement" or who has been invited by a franchisor, a franchisor's associate, agent or broker to enter into such an agreement. "Franchise agreement" in turn includes <u>any</u> agreement relating to a franchise between a franchisor (or its associates) and a franchisee and "franchisee" is defined as being a person to whom a franchise is granted. An addendum agreement or any other agreement, therefore, that a franchisor requires that its existing franchisee execute during the term of their franchise agreement, would fall under the definition of a "franchise agreement". Requiring an existing franchisee to execute an addendum or any other form of agreement even in a post-sale scenario, therefore, would trigger the disclosure obligations based on this strictly technical reading of the Act.[11]

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[10] An addendum agreement, for example, will not fall under any of the following exemptions: Section 5(7)(a) (grant of a franchise), Section 5(7)(c) (grant of an additional franchise) or Section 5(7)(f) (renewal or extension of a franchise agreement), unless the sole purpose of the addendum agreement was to renew or extend the agreement.

[11] The consequences to the franchisee could be even greater where there has been a material adverse change during the period between the date of the original franchise agreement and the date of the proposed addendum or other agreement, thereby triggering in a similar manner, the material change disclosure obligations under Section 5(5) of the Act. Such obligations are subsumed and could be ignored by the franchisor, however, if the franchisor were to provide its franchisee with a wholly new disclosure document at the relevant time.

It is instructive to consider in this regard an Informal Staff Advisory Opinion of the FTC[12] in which the commission concluded that a franchisor is not required to furnish disclosure to an existing franchisee when the franchisee initiated a modification of the franchise agreement. The fact that the FTC would even consider re-disclosure in this kind of a scenario is noteworthy particularly when considering whether there is or should be a similar obligation under the Act, given our analysis above.

Recommendation: There are several ways to address this ambiguity. For example, Section 5 of the Act could be amended to specifically exempt a franchisor from any post-sale disclosure obligations to an existing franchisee. Alternatively, the term "prospective franchisee" could be amended to exclude an existing franchisee and, in such event, the exempting provisions would require some amendment as well. Finally, the term "franchise agreement" could be amended to specifically refer to an agreement required in anticipation of the *purchase* of a franchise and to explicitly exclude any agreement subsequently required to be entered into by a franchisee.

Issue: Section 5(5) of the Act requires that a franchisor provide the prospective franchisee with a:

> "written statement of any material change, and the franchisee must receive such statement, **as soon as practicable after the change has occurred and before the earlier of**, i. the signing by the prospective franchisee of the franchise agreement or any other agreement relating to the franchise; and ii. the payment of any consideration by or on behalf of the prospective franchisee to the franchisor or franchisor's associate relating to the franchise". [Emphasis Added]

The highlighted wording noted above is problematic as it seems to permit a franchisor to provide the statement of material change at any time "before" the franchisee signs any agreement with, or makes any payment to, the franchisor or the franchisor's associate. The lack of clarity associated with the word "before" could provide a franchisor with an opportunity to deliberately or inadvertently limit the amount of time that a prospective franchisee may have to consider and investigate the statement of material change. Though the legislation requires that the statement of material change be provided "as soon as practicable", this standard is open to abuse by franchisors who could potentially argue that they met this less definitive standard of delivery. **Recommendation:** By replacing the words "and before the earlier of" with the words "but not less than 3 days before the earlier of", a prospective franchisee would be entitled to receive at least that number of days during which it could examine the statement of material change.

(e) **Exemptions to the Disclosure Obligation.**

Issue: Pursuant to Section 5(8) of the Act, the grant of a franchise is not considered to have been made "by or through a franchisor merely because the franchisor has a right, exercisable on reasonable grounds, to approve or disapprove the grant". Could a franchisor avail itself of this Section (and therefore the exemption at Section 5(7)(a)) if it insists that the assignee execute an assignment and consent form requiring it to abide by the terms of the existing franchise

[12] See FTC Informal Staff Advisory Opinion 02-3 in which the FTC concluded that a "post-sale, franchisee-initiated, mutually agreed upon modification of an existing franchise agreement's protected territory provision" does not *ordinarily* require re-disclosure. The FTC did not unfortunately elaborate on when such re-disclosure would be required.

agreement and indicating the franchisor's consent to the assignment?[13] The legislation unfortunately provides us with no guidance as to what would be considered reasonable when a franchisor is exercising its right to approve or disapprove the sale of a franchise by a franchisee to a third party assignee. **Recommendations:** Section 5(8) of the Act should be amended to explicitly permit franchisors, acting reasonably, to qualify and train any assignees and to obtain their agreement to abide by the terms and conditions of the assignor's franchise and other agreements.

Issue: Section 5(7)(b) requires that the officer or director receiving the grant of a franchise be an officer or director for "at least 6 months". This section, however, does not indicate whether the 6 months must immediately precede the grant of the disclosure, which would be the most logical interpretation. Given this ambiguity, this exemption may be available to a franchisor even in a case where the franchisee was an officer or director for a period of six months or greater at any time prior to the grant, but was not an officer or director for that period of time prior to the grant itself. **Recommendations:** Section 5(7)(b) should be amended by adding the words ", provided that there has been no material change since the time the said person acted as a director or officer of the franchisor or the franchisor's associate" following the words "for at least six months". This amendment would ensure that this exemption could only be relied upon if the prospective franchisee was fully up-to-date with respect to the franchise, in keeping with the public policy rationale of several other provisions of the Act (i.e., Section 5(7)(c) and 5(7)(f)) which are similarly concerned with the currency of the franchisee's knowledge of the affairs of the franchisor and the franchise system.[14]

Issue: The exemption pursuant to Section 5(7)(c) only applies if the grant is to an "existing franchisee". Franchisees who own and operate multiple units will often hold each such franchise in a separate corporation. If the additional franchise is granted to an affiliate of the franchisee, therefore, then the franchisor may not be able to rely upon this exemption as the grant is not legally made to "an existing franchisee" but to an affiliate of the existing franchisee.[15] **Recommendations:** The words "or its affiliate" should be added to the subsection following the words "existing franchisee".

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[13] It is interesting to consider in this regard the decision in *MAA Diners Inc. et al* v. *3 for 1 Pizza & Wings (Canada) Inc*, (2003-02-10) ONSC 02-CV-232605CM1, where the court held that the franchisor effected the grant of the franchise because all of the meetings between the parties took place at the franchisor's office and one of the franchisor's principals prepared the contractual documents and facilitated or managed the transaction.

[14] It is also important to note that Section 5(7)(b) speaks of a grant that is made directly to a "person who has been an officer or director". Franchisors interested in relying upon this exemption must ensure that the grant is actually made to the said officer or director in his/her personal capacity and not a company owned by the said person, for, otherwise, this exemption would not be available. This Section, therefore, should also be amended to allow for a grant to a company controlled by such an officer or director.

[15] Note also that Section 5(7)(c) sets out a two-pronged test that a franchisor must meet to rely upon this exemption: i. the additional franchise must be "substantially the same as the existing franchise" and ii. there must be "no material change since the existing franchise agreement ... was entered into". Once again, terms like "substantially the same" only create uncertainty and do not provide us with any significant guidance.

Issue: Section 5(7)(d) exempts certain parties from the disclosure obligation if they are controlling the franchise by virtue of an insolvency or bankruptcy, or the death or disability of an individual franchisee. Such parties often do not have a great deal of knowledge regarding the franchise or its operations, nor are they willing to make representations or warranties regarding the franchise to any third party purchaser given that they were essentially "parachuted" into their respective roles and did not have a lengthy history with the franchise. The "estate of the franchisor" exception to this exemption is a curious one, however, since the estate of a franchisor estate would similarly have no substantial knowledge of the franchised operation. **Recommendation:** The "estate of the franchisor" exception should be limited to those circumstances where the estate is being handled by an individual who has, or should have had, knowledge of the affairs of the franchise prior to the estate assuming control over the franchise. Alternatively, this exception to the exemption should be deleted in its entirety.

Issue: The percentage prescribed by the Regulations for exemption under Section 5(7)(e) is currently set at 20% of the total sales of the franchised business. This exemption requires that both the franchisor and the franchisee "anticipate" the level of sales arising from the sale of goods and services of a franchise in relation to the total sales of the business, including the franchised and non-franchised segments of the business, in advance of relying upon this exemption. Franchisors should be cautious when relying upon this dangerous exemption as it is very difficult at times to anticipate sales and the factors that may impact sales are numerous and difficult to predict. In addition, this exemption imposes an objective test upon the franchisor and franchisee ("that should be anticipated by the parties"), thereby opening up the possibility for judicial review and assessment of the originally projected and agreed upon percentages. **Recommendation:** To provide more certainty to the parties desirous of relying upon this exemption, the words "or that should be anticipated by the parties" should be deleted from this Section.[16]

Issue: To rely upon the exemption under Section 5(7)(f) in a renewal scenario, a franchisor must ensure that there was i. no "interruption in the operation of the business operated by the franchisee under the franchise agreement" and ii. no material change since the time that the franchise agreement (or renewal agreement) was entered into. The Act is once again concerned about interruptions in the operation of the franchised business which would place franchisees in a disadvantaged position from a disclosure point of view. This exemption was not, however, designed to preclude franchisees from interrupting the operation of their businesses if such interruption is in the ordinary course of business as in the case where a franchisee temporarily ceases the operation of its franchise to take a short vacation, for example. Also, it is difficult to determine how a franchisee would be prejudiced if there was in fact an interruption in the operation of the business of the type contemplated by Section 5(7)(f), but no material change. **Recommendation:** The overriding issue in this subsection should be solely whether there is a material change that requires a re-disclosure upon renewal of the franchise agreement. This section should therefore be amended by deleting the words "interruption in the operation of the business operated by the franchisee under the franchise agreement and there has been no".

[16] We should, however, recognize the potential risk that by deleting the words "or that should be anticipated by the parties", a franchisor may be in a stronger position to use its influence to encourage or even to force a prospective franchisee to agree to the relative percentages, so that it could rely upon this exemption and avoid its disclosure obligations.

Issues: Under Section 5(7)(g), a franchisor is exempt from providing disclosure to a prospective franchisee if the franchisee is only required to make a "total annual investment to acquire and operate the franchise" in an amount not to exceed a prescribed amount. The Regulations state that this amount is $5,000. Does the amount of $5,000 include any amounts invested by the franchisee in the franchise that may be payable to third parties, i.e., parties other than the franchisor? Or, do the words "to acquire and operate the franchise" suggest that the $5,000 threshold can only be met if such funds are paid directly to the franchisor or only if at the franchisor's behest? Would legal and accounting fees incurred by a franchisee, for example, be included in this amount for the purposes of calculating the $5,000 threshold? **Recommendation:** The words "and operate" suggest that the monies need not be paid directly to the franchisor to be included in this amount of $5,000 but that *any* monies paid in furtherance of acquiring and operating the franchise would be included. As such, this threshold is too low to be meaningful and should be increased to at least $10,000.[17]

Issues: Section 5(7)(h) provides that a franchisor is exempt from giving a disclosure document to a prospective franchisee if the franchisee invests a certain prescribed minimum dollar amount in the franchise and does so over a period of one year. The Regulations provide further that this prescribed amount is $5 million dollars. This section poses two issues which require clarification. First, when does one begin calculating this prescribed period of one year, at the commencement of the franchise term or only upon the date of the franchisee's first investment which could conceivably be at some later time? Second, the $5 million dollar threshold is too high to benefit franchisors. Franchisees who invest amounts much lower than the $5 million threshold are sufficiently sophisticated that they do not require disclosure documents to be adequately protected, given the due diligence that they would typically conduct in any event prior to their purchase. **Recommendation:** First this Section should be amended by clearly stating that this exemption is actually tied to the date upon which the franchisee is required to make the investment to "acquire and operate" the franchise and not the date of the grant itself. Second, the Regulations should lower the threshold amount to a more reasonable figure such as $2 million dollars.

5. **Section 7 - Damages for Misrepresentation**

Issue: This Section provides a franchisee with a right of action as against not only the franchisor, but also, inter alia, the "franchisor's agent and broker" in the event that there is a misrepresentation contained in the disclosure document or in a statement of a material change or as a result of the franchisor's failure to comply with Section 5. "Franchisor's agent", however, is not defined by the Act, thereby causing great consternation amongst employees of franchisors, legal and accounting practitioners, franchise brokers and consultants alike who are employed or act on behalf of the franchisor and who may consequently be deemed to be "agents" under the Act.

From a public policy point of view, furthermore, an agent or a broker should not be held liable under this Section as they will most likely not have much editorial control over the contents of

[17] Finally, please note that Section 5(7)(g) of the Act does not require that the franchisee *actually* make the de minimus annual investment, but that it simply be "required to make" this investment. By entering into an agreement which simply obliges the franchisee to make the investment, therefore, this exemption may be triggered.

the disclosure document, as the compiling of a disclosure document is more often than not within the exclusive domain of the franchisor, its associates or directors, officers or employees of such entities. The same can be said of the franchisors' legal and accounting practitioners, real estate brokers and franchise consultants. This should not be the case however if the agent, broker or other representative is responsible for amending the disclosure document either by way of an oral representation or by written amendment without first receiving the express written consent of the franchisor or such agent, broker or other representative is otherwise acting outside the scope of its authority.

Recommendation: Instead of casting such a wide net over so many people who may have some connection with the franchisor, but no authority to amend the disclosure document, the legislation should exclusively focus on those parties who in fact are authorized to prepare and amend the disclosure document. Such persons would include, the franchisor and its associates, and "every person who signed the disclosure document or statement of material change", most often, certain key employees, directors and/or officers of the franchisor. At the same time, Section 7 should be expanded to give a franchisee a right of action for damages under this section as against any of the franchisor's agents and brokers for any oral or written misrepresentations independently made by them, which were made outside of the scope of their authority. This would more than adequately protect franchisees from any such misrepresentations without imposing potential liability on a broker or agent, for example, for the misrepresentations of the franchisor itself. Finally, the term "agent" should be defined narrowly as an entity who by contract or otherwise represents, or is authorized to act on behalf of, the franchisor.

6. The Use of the Definite Article versus Indefinite Article re: "Franchise Agreement"

Issue: Throughout the Act, the word "the" and "a" interchangeably precede the words "franchise agreement".[18] In those cases where the definite article "the" is used, it is unclear whether a franchisee is permitted to rescind not only the franchise agreement itself, but also any of the other agreements which fall under the definition of "franchise agreement". **Recommendation:** Given the expansive definition of the term "franchise agreement" at Section 1 of the Act, the indefinite article "a" should replace the definite article "the" wherever in the Act that it precedes the words "franchise agreement". By so doing, these sections would be more inclusive and would more appropriately suggest that there may be more than one "franchise agreement" being executed by the parties.[19]

This concludes the first segment of this paper. Recommendations for Amendment of the Regulations will be published in the next edition of the Franchise and Distribution Journal.

[18] For example, Section 6(1) allows a franchisee to rescind "the franchise agreement" if the franchisor failed to provide it with the disclosure document or statement of material change (or the contents of the document did not meet the statutory requirements).

[19] Invariably, there are a number of ancillary agreements that accompany the franchise agreement itself. In addition, Section 5(4)(c) correctly uses the plural form when referencing "franchise agreements", notwithstanding the superfluous usage of the wording that directly follows (i.e., "and other agreements relating to the franchise").