

# The Law of Franchising in Canada: An Introduction

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Canada is often favourably viewed as one of the top destinations for franchise expansion internationally. Indeed, Canada is one of the most desirable markets in franchising today (especially for US franchisors) as it is regularly ranked in the top 10 countries in the world in terms of the number of franchise brands operating within the country. The Canadian Franchise Association claims that Canada has over 80,000 operating franchises across Canada, and that franchising directly employs over 1 million people.<sup>1</sup>

Notwithstanding its seductive appeal, however, international franchising is a complicated enterprise that requires specific expertise that goes well beyond a good understanding of the business principals and legal complexities of both the business in question and the domestic franchised model. While international franchising certainly has the potential to bring healthy returns, franchisors are cautioned to tread very carefully when expanding in the international arena for it is a possible minefield for the unwary and uninitiated....

## Canadian Franchising Environment

### (a) Canadian Jurisdictions with Franchise Specific Legislation:

Presently, there are three Provinces which have franchise specific legislation in force: Ontario, Alberta and Prince Edward Island (PEI). New Brunswick has enacted its provincial franchise legislation, the Franchises Act, however, this legislation has not yet been proclaimed into force. Although the legislation in all four jurisdictions are similar, the legislation found in PEI and New Brunswick are most similar to each other since they are both largely modelled upon the Uniform Law Conference of Canada's Model Franchise Act. In addition to the above-noted Provinces that have franchise-specific legislation in force, the Province of Manitoba is also in the process of considering the introduction of franchising legislation.

### (b) Legislative Requirements for Ontario:

While the franchise disclosure statutes in force in the Provinces of Ontario, Alberta and PEI are similar to each other in many ways, it is important to note that there are some significant differences among them as well. Given that we wish to provide only a cursory summary of some of the issues foreign franchisors may encounter in Canada, the balance of this paper will focus exclusively on franchising in the province of Ontario and the application of the Arthur Wishart Act (Franchise Disclosure), 2000 (the "Ontario Act") to franchising in this province.

### Exemptions from the Act and Disclosure Obligations:

The Ontario Act provides for certain exceptions from the entire application of the Ontario Act in general, and also provides for certain exemptions to the disclosure obligation in particular.

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### Disclosure Obligation:

Pursuant to section 5 of the Ontario Act, franchisors are obligated to provide disclosure to prospective franchisees in the form of a disclosure document that is provided to the franchisee not less than 14 days before the execution of a franchise agreement<sup>2</sup> or payment of any monies to the franchisor or franchisor's associate. The disclosure document must be delivered at one time as one document and may be delivered personally, by registered mail or by any other method prescribed by Regulation. Any purported waiver or release by a franchisee of a right given under the Ontario Act or of an obligation or requirement imposed on a franchisor or franchisor's associate by or under The Act is void.<sup>3</sup>

It is important to emphasise that the list of information prescribed by the Ontario Regulations to be included in a disclosure document is not an all inclusive one and that the over-arching obligation is to disclose all "material information", which may include information that is not explicitly set out in the Regulations. Such additional information may yet still impact the prospective franchisee's decision to purchase the franchise, and therefore franchisors should always err on the side of caution and disclose any other information which may be considered "material" in addition to the prescribed disclosure under the Regulations. »

In addition, and as noted below, it is important to note that the disclosure document must be current at all times not only at the time of disclosure, but also up to the earlier of the execution date of any franchise agreement and the payment by the franchisee to the franchisor of any funds. Therefore, foreign franchisors are required to regularly review their documents for accuracy and to update them as facts and circumstances change so that they may easily make accurate disclosure when and if required.

#### Definition of "Material Fact" and Material Change Statement...

##### Material Fact:

As noted above, a franchisor is obliged to disclose all "material facts" in the disclosure document to be provided to any prospective franchisee. Material facts are defined in the Ontario Act as "any information about the business, operations, capital or control of the franchisor or franchisor's associate, or about the franchise system, that would reasonably be expected to have significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise". Once again, this definition is not an exclusive one and there may be occasions where a piece of information may not necessarily have a significant effect on the value or price of the franchise to be granted or otherwise impact the prospective franchisee's decision to purchase the franchise, but still may be deemed to be a "material fact" under the Ontario Act.

##### Material Change:

In addition to the disclosure of material facts and the prescribed information, the franchisor is obligated to provide the prospective franchisee with a written statement of material change as soon as practicable after the occurrence of any such material change and before the earlier of (1) the signing of the franchise agreement (or any other agreement relating to the franchise) and (2) the payment of any amounts by or on behalf of the potential franchisee to the franchisor.<sup>4</sup>

##### Ramifications for Failure to Disclose:

Should a franchisor fail to provide a disclosure document or a statement of material change in accordance with requirements of the Ontario Act, or fail to provide a disclosure document at all, such a

franchisor may face serious legal ramifications.<sup>5</sup>

A franchisee has a right to rescind the franchise agreement for a period of two years after entering into the franchise agreement if the franchisor fails entirely to provide a disclosure document to the franchisee.<sup>6</sup> If late or incomplete disclosure is provided to the prospective franchisee, the prospective franchisee may rescind the franchise agreement for a period of 60 days after receiving the disclosure document.<sup>7</sup> Late disclosure occurs if the franchisor fails to provide a disclosure document or a statement of material change within the time required and incomplete disclosure occurs if the contents of the disclosure document do not meet the requirements of the Ontario Act.

An important issue yet to be resolved in Ontario is whether a disclosure document can be so incomplete that it constitutes no disclosure at all under the Ontario Act thereby extending the franchisee's right of rescission from 60 days to 2 years. The Ontario Court of Appeal<sup>8</sup> considered this important issue in the *Dig this Garden* case.

#### Duty of Fair Dealing and Good Faith and the Right of Association:

The Ontario Act imposes a few relationship-based obligations, namely, a duty of fair dealing and good faith and the right of franchisees to associate. Non-compliance with these statutory obligations provides the maligned party with certain statutory remedies.

## Protecting Your Intellectual Property

An integral part of any franchise system, whether domestic or foreign based, is a franchisor's intellectual property. It is therefore necessary to ensure that a franchisor protect its applicable trade-marks, copyrights and patents in Canada.

Canada is not a party to the Madrid Protocol and, as such, a separate application is required to register the foreign franchisor's trade-marks in Canada. However, as Canada is a signatory to the International Convention for Protection of Industrial Property (the Paris Convention), applicants from member countries can base Canadian trade-mark applications on registration and use in a foreign jurisdiction, or a combination of these. Canadian trade-mark applications may also be based on use or proposed use in Canada.

## Franchise Documentation Issues



When expanding one's franchise system into Canada, the foreign franchisor's Canadian lawyer should advise that the franchise documentation the franchisor had utilised in its host jurisdiction will need to be "Canadianized" before being employed in Canada.



## Industry Specific Legislation

In addition to franchise specific legislation, foreign franchisors operating in Canada need to be alert to laws, regulations and other regulatory issues which may be directed at their particular industries or business activities. Examples include liquor licensing, consumer protection and provincial regulatory and licensing bodies which have established specific requirements that impose certain professional and ethical standards upon their respective members.

<sup>1</sup>Canadian Franchise Association Press Release ("Asking the Right Questions") dated February 28, 2008.

<sup>2</sup>A "franchise agreement" means any agreement that relates to a franchise between, (a) a franchisor or franchisor's associate, and (b) a franchisee. This expansive definition encompasses much more than simply a franchise agreement. Confidentiality and deposit agreements, for example, would fall under this Ontario Act definition.

<sup>3</sup>Section 11 of the Ontario Act.

<sup>4</sup>The Ontario Act defines "material change" as "a change in the business, operations, capital or control of the franchisor or franchisor's associate, a change in the franchise system or a prescribed change, that would reasonably be expected to have a significant adverse effect on the value or price of the franchise to be granted or on the decision to acquire the franchise and includes a decision to implement such a change made by the board of directors of the franchisor or franchisor's associate or by senior management of the franchisor or franchisor's associate who believe that confirmation of the decision by the board of directors is probable."

<sup>5</sup>A franchisee also has a right of action for damages if a franchisee suffers a loss because of a misrepresentation contained in the disclosure document, in a statement of a material change or as a result of the franchisor's failure to comply in any way with Section 5 of the Ontario Act against, the franchisor, the franchisor's agent, the franchisor's



## Conclusion

Franchising in Canada is a worthwhile endeavour for most international franchisors to consider pursuing, provided that it is done carefully and under the guidance of the foreign franchisor's domestic and Canadian legal, accounting and franchising professionals. There are no assurances that success in a foreign franchisor's domestic market can be replicated in a country such as Canada. The possibility for success however will be enhanced if steps are taken to thoroughly consider the various issues involved when franchising internationally<sup>9</sup>, including those specifically pertaining to the application of local laws, customs and practice within Canada. ■

broker, being a person other than the franchisor, franchisor's associate, franchisor's agent or franchisee, who grants, markets or otherwise offers to grant a franchise, or who arranges for the grant of a franchise, the franchisor's associate and every person who signed the disclosure document or statement of material change.

<sup>6</sup>Subsection 6(2) of the Ontario Act.

<sup>7</sup>Subsection 6(1) of the Ontario Act.

<sup>8</sup>1490664 Ontario Ltd. v. Dig this Garden Retailers Ltd. (2005), 7 B.L.R. (4th) 1.

<sup>9</sup>For a detailed examination of some additional issues involved in franchising internationally, see Joseph Y. Adler and Paul Jones, "Bringing A Foreign Franchise System to Canada," Paper and Presentation to Ontario Bar Association's 5th Annual Franchise Law Conference, Toronto, September 21, 2005.



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