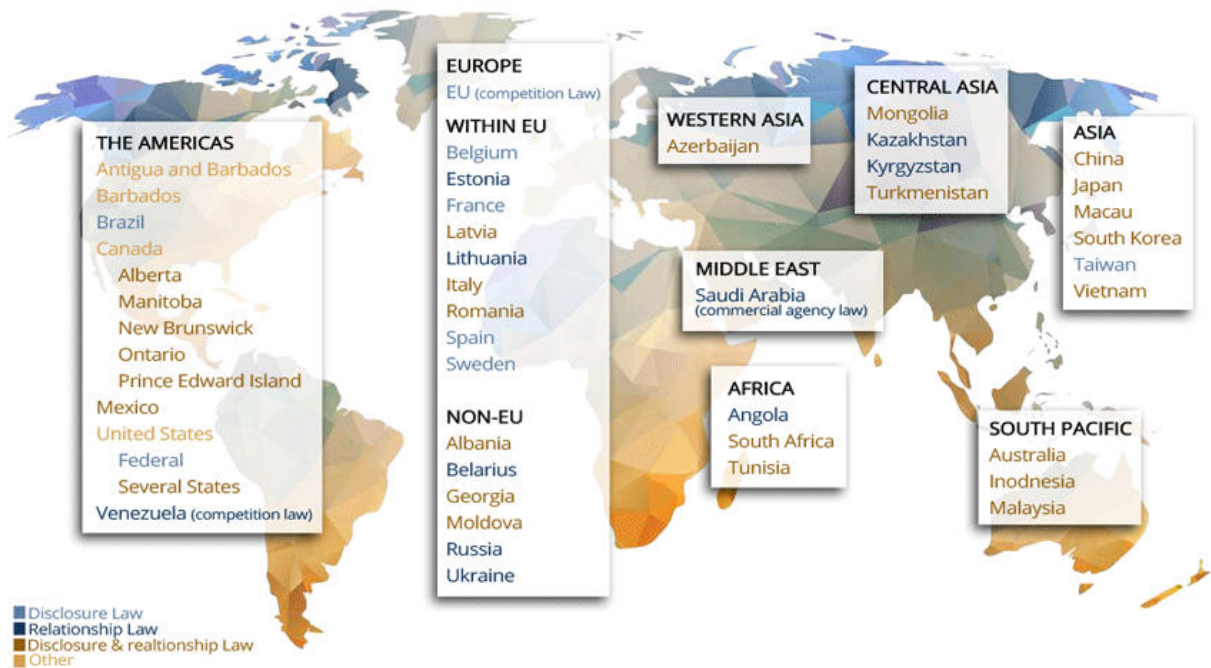




INTERNATIONAL RESOURCES ABSTRACT

Laws and agencies that regulate the offer and sale of franchises



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Which laws and government agencies regulate the offer and sale of franchises?

Currently adopted franchise legislation is limited to the Alberta Act, the Ontario Act, the PEI Act, the NB Act and the Manitoba Act (collectively, the Canadian Franchise Acts), and no other province or territory of Canada has regulated the offer and sale of franchises through franchise-specific legislation.

What are the exemptions and exclusions from any franchise laws and regulations?

Exemptions exist in each of the Canadian Franchise Acts, other than the Alberta Act, as follows:

Full exemptions

The Canadian Franchise Acts, other than the Alberta Act, do not apply to the following commercial relationships:

- employer–employee relationships;
- partnerships;
- memberships in a cooperative association, as prescribed in the NB Act, the PEI Act or the regulations to the Ontario Act, as the case may be;
- arrangements for the use of a trademark, trade name or advertising to distinguish a paid-for evaluation, testing or certification service for goods, commodities or services;
- arrangements with a single licensee in respect of a specific trademark, trade name or advertising if it is the only one of its general nature and type to be granted in Canada;
- any lease, licence or similar agreement for space in the premises of another retailer where the lessee is not required or advised to buy the goods or services it sells from the retailer or any of its affiliates (Ontario Act only);
- oral relationships or arrangements without any writing evidencing any material term or aspect of the relationship or arrangement;
- a service contract or franchise-like arrangement with the Crown or an agent of the Crown (except the Manitoba Act); and
- an arrangement arising out of an agreement for the purchase and sale of a reasonable amount of goods at a reasonable wholesale price or for the purchase of a reasonable amount of services at a reasonable price (except the Ontario Act).

Partial exemptions – the obligation to disclose

All of the Canadian Franchise Acts, other than the Alberta Act, contain exemptions from disclosure requirements that include, for example, the sale of a franchise to a person to sell goods or services within a business in which that person has an interest, provided that the sales arising from those goods or services do not exceed 20 per cent of the total sales of the business.

Exemptions are also set out in the Canadian Franchise Acts in connection with the granting of a franchise if the prospective franchisee is required to make a total annual investment to acquire and operate the franchise in an amount that does not exceed the amount prescribed under each of the Canadian Franchise Acts, currently C\$5,000.



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Exemptions exist in the Alberta Act with respect to the obligation to provide a disclosure document as follows:

- ⌚ sale of a franchise by a franchisee provided that:
- ⌚ the franchisee is not the franchisor or an associate, director, officer or employee of the franchisor;
- ⌚ the sale is for the franchisee's own account;
- ⌚ the sale is not effected by or through the franchisor; and
- ⌚ in the case of a master franchise, the entire franchise is sold;
- ⌚ sale of a franchise to a person who has been an officer or director of the franchisor or its associate for at least six months for that person's own account;
- ⌚ sale of an additional franchise to an existing franchisee if the additional franchise is substantially the same as the franchise that the franchisee is operating;
- ⌚ a renewal or extension of an existing franchise agreement;
- ⌚ sale of a franchise by an executor, administrator, sheriff, receiver, trustee, trustee in bankruptcy or guardian on behalf of a person other than the franchisor or the estate of the franchisor;
- ⌚ sale of a right to a person to sell goods or services within or adjacent to a retail establishment as a department or division of the establishment, if the person is not required to purchase goods or services from the operator or the retail establishment; and
- ⌚ sale of a franchise to a person to sell goods or services within a business in which that person has an interest, provided that the sales arising from those goods or services do not exceed 20 per cent of the total sales of the business.

The exemptions set out in each of the Canadian Franchise Acts, while substantively similar, are not identical. Under the Ontario Act, the sale of a franchise to a franchisee who invests more than a prescribed amount (currently C\$5 million) in the acquisition and operation of the franchise over a prescribed period (currently one year) is exempted from the application of the disclosure requirements. One does not have to comply with the disclosure requirements under the Alberta Act when granting a licence to a person to sell goods or services within or adjacent to a retail establishment as a department or division of said establishment without requiring that the person purchase goods or services from the operator of the retail establishment.

Under the Manitoba Act, a franchisor is not required to provide financial statements to a franchisee if the franchisor meets certain criteria, including:

- ⌚ a net worth of at least C\$5 million or, alternatively, having a net worth of at least C\$1 million to the extent that the franchisor is controlled by a corporation whose net worth is at least C\$5 million; or
- ⌚ the existence of at least 25 of its franchisees engaged in business in Canada at all times during the five-year period preceding the date of the disclosure document. In addition, each of the Canadian Franchise Acts other than the Alberta Act affirms that a franchisor may apply for a



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ministerial exemption allowing it not to include its financial statements in a disclosure document.

Does any law or regulation create a requirement that must be met before a franchisor may offer franchises?

Except for compliance with applicable Canadian Franchise Acts and other legislation, there is no requirement – for example, that a franchisor be in business for a minimum period, that a franchisor has operated a minimum number of franchisor-owned operations, or that a franchisor has operated in Canada with franchisor-owned operations for a minimum period – that must be met before a franchisor may offer franchises.

Are there any laws, regulations or government policies that restrict the manner in which a franchisor recruits franchisees or selects its or its franchisees' suppliers?

There are no generally applicable restrictions governing the recruitment and selection of franchisees or franchisee's suppliers. However, it is important to note that such restrictions do exist in certain industries whose products or services are specifically regulated, such as the tobacco industry and the alcohol industry.

In the case of a sub-franchising structure, who must make pre-sale disclosures to sub-franchisees? If the sub-franchisor must provide disclosure, what must be disclosed concerning the franchisor and the contractual or other relationship between the franchisor and the subfranchisor?

Each of the Canadian Franchise Acts imposes the obligation to disclose upon 'franchisors', the definition of which includes a subfranchisor with regard to its relationship with a sub-franchisee.

Accordingly, pre-sale disclosures must be made to a sub-franchisee by the sub-franchisor in accordance with the same procedural and substantive requirements, and exemptions pertaining thereto, that apply to franchisors with regard to their relationships with their franchisees. Moreover, information regarding a sub-franchisor's relationship with the franchisor must be disclosed to a prospective sub-franchisee, but only to the extent that such information constitutes a material fact or is necessary for the sub-franchisor to properly acquit itself of its duty to furnish the information expressly prescribed by the relevant statutory and regulatory provisions governing disclosure.

Is there any obligation for continuing disclosure?

None of the Canadian Franchise Acts require continuing disclosure beyond the signing of the franchise agreement or the payment of any consideration by the prospective franchisee to the franchisor with respect to the franchise, whichever occurs first. Before this point, any material change, defined as any change or prescribed change that could reasonably be expected to have a significant adverse effect on



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the value or the price of the franchise to be granted or on the decision to acquire the franchise, must be brought to the prospective franchisee's attention as soon as practicable.

Despite the lack of explicit continuing disclosure requirements, each of the Canadian Franchise Acts contains a broadly stated obligation of fair dealing. The possibility cannot yet be ruled out that Canadian courts might interpret fair dealing as requiring disclosure of certain material information under certain circumstances.

How do the relevant government agencies enforce the disclosure requirements?

Disclosure requirements are typically enforced by the affected parties rather than by government agencies as the interests are generally considered to be private rather than public.

In addition to any laws or government agencies that specifically regulate offering and selling franchises, what are the general principles of law that affect the offer and sale of franchises? What other regulations or government agencies or industry codes of conduct may affect the offer and sale of franchises?

General principles of law that may affect the offer and sale of franchises vary depending on the province in which a franchisor wishes to grant franchises.

In all provinces of Canada other than Quebec, general commonlaw principles regarding contract formation govern the offer and sale of franchises. In Quebec, franchise agreements are governed by the general principles of contract formation found in the Civil Code of Quebec and are generally regarded as contracts of adhesion. The Civil Code of Quebec, in an effort to correct a presumed economic imbalance between the parties, provides more favourable interpretation principles and a significantly broader margin of redress for the adhering party to a contract of adhesion than that which would be available absent a contract of adhesion. Furthermore, an abusive clause in a contract of adhesion will be considered null, or the obligation arising from it may be reduced by a court.

Do other laws affect the franchise relationship?

The ongoing franchise relationship is subject to generally applicable federal and provincial statutes and the principles of contractual law that emanate from the common law or, in Quebec, the civil law.

Canadian courts have been pragmatic in their approach to ongoing relational matters as they relate to franchising. The clear and express terms of a franchise agreement will be determinative of the issues arising in connection with same. If such agreements are unclear on a given point, courts will generally construct the litigious terms in a manner that provides for a 'sensible commercial result'.

This has not, however, prevented courts from rendering judgments against franchisors that excessively and unlawfully interfere with the economic interest of their franchisees.