GETTING THE DEAL THROUGH

Franchise

in 30 jurisdictions worldwide

2014

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Overview

1 What forms of business entities are relevant to the typical franchisor?

There are several different vehicles available to foreign franchisors who wish to carry on business in Canada, each with varying tax and corporate consequences.

The preferred choice of vehicle used for the expansion of a foreign franchise system into Canada is the incorporation of a Canadian subsidiary. By using a Canadian subsidiary, the franchisor has a local direct physical presence and indicates to the general public that it has made a commitment to Canada. Foreign franchisors may instead wish to enter the Canadian market by franchising directly from their country without the creation of a permanent establishment in Canada, thus avoiding being considered by Canadian tax authorities as carrying on business in Canada (see question 5).

2 What laws and agencies govern the formation of business entities?

The federal legislation under which a corporation may be incorporated is the Canada Business Corporations Act (CBCA). Provinces have also enacted similar statutes regulating the formation of corporate entities. The formation of partnerships and other non-corporate entities is governed solely by legislation that is specific to each province. Business entities must usually register with the relevant corporate or business registry of each province in which they wish to conduct business.

3 Provide an overview of the requirements for forming and maintaining a business entity.

Registration mechanisms for forming and maintaining business entities in Canada are generally straightforward, requiring little more than the payment of prescribed fees and the filing of specific corporate or business registry forms that describe, inter alia, the nature of the business, its structure, the scope of its undertakings and basic information regarding its shareholders and directors. Annual filings are also typically required in each of the provinces in which a business entity carries on business and, in the case of corporations incorporated under the CBCA, at the federal level.

4 What restrictions apply to foreign business entities and foreign investment?

Pursuant to the Investment Canada Act, foreign business entities seeking to acquire or establish a Canadian business are required to notify Industry Canada no later than 30 days following such acquisition or establishment. An onerous and thorough review process applies to non-World Trade Organization investors where the asset value of the acquired Canadian business is at least C$5 million for direct acquisitions or C$50 million for indirect acquisitions. The same is true in the case of World Trade Organization investors acquiring control of a Canadian business, but only in cases of direct acquisitions where the asset value of the Canadian business is at least C$344 million (threshold is indexed to the growth in nominal GDP); most franchisors do not meet this threshold. Bill C-60, which was passed in the House of Commons on 10 June 2013, proposes to gradually raise this threshold to an 'enterprise value' of C$1 billion, over a four-year period.

Furthermore, it is important to note that certain corporate statutes, such as the CBCA and the Ontario Business Corporations Act, set out requirements as to the residency of directors pursuant to which at least one director (or 25 per cent of the directors if there are more than four) must be a Canadian resident. The corporate statutes of other provinces, such as British Columbia and Quebec, do not impose similar residency requirements.

5 Briefly describe the aspects of the tax system relevant to franchisors. How are foreign businesses and individuals taxed?

Generally, three business structures are available to a franchisor wishing to export its franchise system into Canada.

- A foreign franchisor may choose to contract directly with its Canadian franchisees without carrying on business in Canada directly or through a permanent establishment in Canada. In such an event, income earned in Canada by the franchisor through royalty payments and rent would be characterised as passive income and subject in Canada to a withholding tax only. The standard withholding tax rate of 25 per cent under Canadian income tax legislation is often reduced to 10 per cent by tax treaties entered into between Canada and other jurisdictions – these should be carefully reviewed and considered at the structural stage of planning any entry into the Canadian market.
- A franchisor may opt to carry on business in Canada using a Canadian branch or division. If the franchisor carries on business in Canada through a fixed place of business or permanent establishment, any income derived in respect thereof will generally qualify as 'business income' that is taxable in Canada on a net income basis. Furthermore, the income of a non-resident franchisor carrying on business through a Canadian branch will typically be subject to a 'branch tax' that is payable at the time the earnings of the subsidiary are accrued (and not at the time the income is paid to the foreign franchisor). In light of the foregoing, few franchisors choose to establish a branch office or division for the purpose of expanding into the Canadian market.
- A franchisor may choose to carry on business in Canada through a federally or provincially incorporated subsidiary. This is the most frequently used vehicle by non-resident franchisors wishing to export a franchise system into Canada. The incorporation of a subsidiary presents certain advantages, including the avoidance of Canadian withholding tax on passive income. Nonetheless, the subsidiary's income would be taxable in Canada on a net income basis and dividends paid to its parent

would be subject to a withholding tax of 25 per cent. This rate is often reduced to between five and 15 per cent by tax treaties entered into between Canada and other jurisdictions. The franchisor may also charge a reasonable fee for providing assistance to its Canadian subsidiary in the operation of its business activities with the expectation that a reasonable portion of such fee may then be deducted from the subsidiary's income for tax purposes. Normally, a fee negotiated between arm's-length parties would meet the reasonability test.

In conclusion, significant business and tax consequences arise from each of the above-mentioned structures – a thorough review of all relevant Canadian legislation pertaining to each structure and a careful evaluation of the impact of tax treaties ratified by Canada is highly advised.

6 Are there any relevant labour and employment considerations for typical franchisors? What is the risk that a franchisee or employees of a franchisee could be deemed employees of the franchisor? What can be done to reduce this risk?

Each Canadian province has enacted its own health and safety, employment standards and labour relations legislation. Accordingly, provincial laws and regulations govern most matters relating to labour law (for example, minimum wages, hours of work, overtime, leave, termination of employment, union certification and collective bargaining rights).

Each franchisee must operate as a truly independent and distinct entity from its franchisor so as to be considered a separate employer for labour union certification and collective bargaining purposes. Additionally, even if the franchisee is separately incorporated and operates independently, it is imperative to ensure that there exists no common control or direction emanating from the franchisor that is greater than that which typically characterises the franchisor–franchisee relationship. To do otherwise would be to run the risk of having a union certification or collective agreement with respect to one franchisee being extended to other franchised or corporate outlets. Furthermore, most provincial jurisdictions recognise successor liability following a transfer or sale of a business, such that the new employer is bound by the union certification and, in certain circumstances, by the collective bargaining agreement concluded with the union representing the employees of the sold business.

7 How are trademarks and know-how protected?

The Trademarks Act (Canada) defines a trademark as a 'mark that is used by a person for the purpose of distinguishing or so as to distinguish wares or services manufactured, sold, leased, hired or performed by him from those manufactured, sold, leased, hired or performed by others, a certification mark, a distinguishing guise or a proposed trademark'. As such, distinctiveness is central to the definition and a trademark need not be registered to be valid, or even licensed, in Canada. Nonetheless, registration with the Canadian Office of Intellectual Property has the advantage of providing nationwide protection of the registered trademark and, in the Province of Quebec, enables the use of any English-only terminology that is a registered trademark (provided that no French version of the trademark has been registered and that a generic description of the goods and services is included in French) on catalogues, brochures, public signs and certain other commercial advertising in circumstances where the same would, as a practical matter, be prohibited absent registration. An application for registration may be filed on several bases, namely on previous use or making known in Canada, proposed use in Canada or on foreign use and registration.

Remedies available following the breach of exclusive use clauses or the use of a confusing trademark range from injunctive remedies to passing-off actions that may be instituted before either the Federal Court of Canada or the provincial superior court with territorial jurisdiction.

There is no statutory protection of know-how in Canada. Parties must rely on common law tort and contractual undertakings to protect know-how from unauthorised disclosure or use. Accordingly, the nature of the confidential information that a franchisor wishes to protect, as well as the legal consequences arising as a result of its dissemination, should be clearly identified by the contracting parties in their franchise agreement.

8 What are the relevant aspects of the real estate market and real estate law?

With the exception of the province of Quebec, all provincial property laws are based on the English common law system, pursuant to which real estate can either be held in fee simple or by way of a leasehold interest. Such interest is registered with the public land registry. Quebec's property laws are based on the French civil law system. They require the registration of ownership rights and permit the registration of lease rights in the public land registry.

No particular restrictions exist as to the nature of the arrangement to be concluded between the franchisor and the franchisee with regard to real (or, in civil law, immoveable) property. For instance, a franchisor may wish to enter into a head lease and sublease the premises to a franchisee. In such circumstances, cross-default provisions as between the sublease and the franchise agreement are advisable so that a right to terminate for breach of one gives rise to a right to terminate the other. In the absence of such provisions, the franchise agreement and the sublease will be construed as two independent contracts and breach of one may not have any bearing on the other. Moreover, it is advisable to include automatic termination provisions in a sublease and a franchisor's right to terminate in a franchise agreement in circumstances where the head lease is terminated.

Generally, foreign ownership of, or the transfer to non-residents of, real estate situated in Canada is not restricted, save for those instances where such real estate benefits from statutory protection given its cultural or historical significance.

Laws and agencies that regulate the offer and sale of franchises

9 What is the legal definition of a franchise?

The offer and sale of franchises in Canada is regulated by the provinces rather than by the federal government. Definitive franchise legislation is currently in force in five Canadian provinces: Alberta, Ontario, New Brunswick (NB), Prince Edward Island (PEI) and Manitoba. The most recent of these provinces whose franchise legislation is currently in force is Manitoba, whose legislation came into force on 1 October 2012. In addition, the Civil Code of Quebec contains provisions applicable to all contracts governed by Quebec law, including franchise agreements.

The Arthur Wishart Act (Franchise Disclosure) in the Province of Ontario (the Ontario Act), the Prince Edward Island Franchises Act (PEI Act), the New Brunswick Franchises Act (the NB Act) and the Manitoba Franchises Act (the Manitoba Act) each generally define a 'franchise' as a right to engage in a business where the franchisee is required to make one or several payments to the franchisor in the course of operating the business or as a condition of acquiring the franchise or commencing operations, and in which the franchisee is granted either:

- the right to sell goods or services substantially associated with the franchisor's trademarks in circumstances where the franchisor or any of its associates has significant control over, or offers significant assistance in, the franchisee's method of operation; or

- representational or distribution rights to sell goods or services supplied by the franchisor or its designated supplier, and the franchisor (or any person it designates) provides location assistance to the franchisee.

The Ontario Act, the PEI Act and the NB Act apply to franchise agreements entered into on or after 1 July 2000, 1 July 2006 and 1 February 2011, respectively, and to renewals or extensions of franchise agreements, regardless of whether such franchise agreements were entered into before or after such date, provided that the business operated pursuant to such franchise agreements is to be operated partly or entirely in Ontario, PEI or NB, respectively. The Manitoba Act is conceptually similar and applies to franchise agreements entered into, renewed or extended on or after 1 October 2012. Furthermore, there is no residency requirement in respect of the franchisee with respect to whom the Ontario Act, the PEI Act, the NB Act or the Manitoba Act applies.

In Alberta's Franchises Act (the Alberta Act), a 'franchise' is defined as a right to engage in a business:

- in which goods or services are sold, offered for sale or distributed under a marketing or business plan substantially prescribed by the franchisor or any of its associates and that is substantially associated with any of its trademarks, service marks, trade names, logotypes or advertising; and
- that involves a continuing financial obligation of the franchisee to the franchisor or any of its associates and significant continuing operational controls by the latter on the operation of the franchised business, or the payment of any franchise fee (the latter fee being defined as any direct or indirect payment to purchase or to operate a franchise), and includes a master franchise and subfranchise.

The Alberta Act applies to the sale of a franchise made on or after 1 November 1995 if the franchised business is to be operated partly or entirely in Alberta and if the purchaser of the franchise is an Alberta resident or has a permanent establishment in Alberta for the purposes of the Alberta Corporate Tax Act.

Given the breadth of these definitions, Canadian franchise legislation may cover a number of business agreements and traditional distribution or licensing networks that would not typically qualify as franchise agreements, as the term 'franchise agreement' may be understood in other jurisdictions.

10 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.

11 Describe the relevant requirements of these laws and agencies.

The Canadian Franchise Acts set forth a number of requirements governing the relationship between a franchisor and a franchisee, the principal ones being the duty of fair dealing imposed upon the parties in respect of their performance of the franchise agreement, the obligation of franchisors to disclose material and prescribed information to prospective franchisees in compliance with the relevant statutory and regulatory scheme, and the statutory right of franchisees to associate with each other and form an organisation.

12 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.

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

13 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.

14 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.

15 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 sub-franchisor?

Each of the Canadian Franchise Acts imposes the obligation to disclose upon 'franchisors', the definition of which includes a sub-franchisor 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.

16 What is the compliance procedure for making pre-contractual disclosure in your country? How often must the disclosures be updated?

A franchisor governed by any of the Canadian Franchise Acts must furnish a prospective franchisee with a disclosure document not less than 14 days before the earlier of the signing by the prospective franchisee of the franchise agreement or any other agreement relating to the franchise, or the payment of any consideration by or on behalf of the prospective franchisee to the franchisor or any of its associates relating thereto.

All of the Canadian Franchise Acts, other than the Ontario Act, exclude confidentiality and site selection agreements from the definition of franchise agreements for the application of the disclosure requirements. In addition, the Alberta Act also exempts agreements that only contain terms and conditions relating to a fully refundable deposit (that is, a deposit that does not exceed 20 per cent of the initial franchise fee and is refundable without any deductions or any binding undertaking of the prospective franchisee to enter into any franchise agreement).

A franchisor must also furnish a prospective franchisee under each of the Canadian Franchise Acts with a description of any 'material change' as soon as practicable after the change has occurred and prior to the earlier of the signing of any agreement or the payment of any consideration by the prospective franchisee in relation to the franchise. A 'material change' is defined as a change (even if not yet implemented in certain cases) in the business, operations, capital or control of the franchisor or any of its associates, or in the franchise system, which change would reasonably be expected to have a significant adverse effect on the value or price of, or on the decision to acquire, the franchise.

17 What information must the disclosure document contain?

The regulations under each of the Canadian Franchise Acts require that general information concerning the franchisor be included in the relevant disclosure document. Such information includes the history of the franchisor, the business background of its directors, the general partners and the officers of the franchisor, and whether any of those persons has been subject to bankruptcy or insolvency proceedings or has been previously convicted of fraud or unfair or deceptive business practices. While substantively similar, the list of information that must be disclosed under each of the Canadian Franchise Acts is not identical.

Financial statements must be included in the disclosure document governed by the Canadian Franchise Acts, although the requirements set out in the regulations adopted under the Alberta Act (Alberta Regulations) differ substantially from those adopted under the other Canadian Franchise Acts. For instance, the latter regulations compel the inclusion in each disclosure document of statements regarding initial 'risk factors', whereas those are not required under the Alberta Regulations.

The disclosure document must also include all 'material facts'. This encompasses any information about the business, operations, capital or control of the franchisor, its associates or the franchise system that would reasonably be expected to have a significant effect on the decision to acquire or the value of the franchise.

18 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 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.

19 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.

20 What actions can franchisees take to obtain relief for violations of disclosure requirements? What are the legal remedies for such violations? How are damages calculated? If the franchisee can cancel or rescind the franchise contract, is the franchisee also entitled to reimbursement or damages?

Under each of the Canadian Franchise Acts, an action for damages or rescission may be instituted by the franchisee for non-compliance. The NB Act provides that a party to a franchise agreement may, in the event of a dispute with another party to such agreement, trigger a mandatory alternative dispute resolution mechanism (mediation). The foregoing does not, however, preclude any party to such franchise agreement from availing itself of other recourses available under contract or at law.

Rescission

Pursuant to all Canadian Franchise Acts, other than the Alberta Act, a franchisee may rescind the franchise agreement without penalty or obligation: 'for late disclosure', no later than 60 days after receiving the disclosure document if the franchisor failed to provide said document or a statement of material change within the prescribed time or if the contents of the disclosure document do not satisfy statutory requirements; or 'for absence of disclosure', no later than two years after entering into the franchise agreement. In either case, within 60 days of the effective date of rescission the franchisor must:

- purchase from the franchisee any remaining inventory, supplies and equipment purchased pursuant to the franchise agreement, at a price equal to the purchase price paid by the franchisee, and refund any other money paid by the franchisee; and
- compensate the franchisee for the difference between any losses incurred in acquiring, setting up and operating the franchise, and any amounts paid or refunded pursuant to the preceding paragraph.

Should a franchisor fail to provide the disclosure document as required under the Alberta Act, the prospective franchisee is entitled to rescind the franchise agreement by giving a cancellation notice to the franchisor or its associate, as the case may be, no later than the earlier of 60 days after receiving the disclosure document or two years after the grant of the franchise.

The franchisor does not have an obligation to purchase any of the franchisee's assets under the Alberta Act but must instead, within 30 days after receiving a cancellation notice, compensate the franchisee for any net losses incurred by the latter in acquiring, setting up and operating the franchised business.

Damages

Pursuant to all Canadian Franchise Acts, other than the Alberta Act, if a franchisee suffers a loss because of 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 any disclosure requirements, the franchisee has a right of action for damages against the franchisor, the franchisor's broker (if any), the franchisor's associates, every person who signed the disclosure document or statement of material change and, under the Ontario Act, the franchisor's agent, all of whom are jointly and severally liable.

Under the Alberta Act, a franchisee who suffers a loss resulting from a misrepresentation contained in a disclosure document has a right of action for damages against the franchisor and every person who signed the disclosure document, on a joint and several basis.

21 In the case of sub-franchising, how is liability for disclosure violations shared between franchisor and sub-franchisor? Are individual officers, directors and employees of the franchisor or the sub-franchisor exposed to liability? If so, what liability?

Liability is imposed on franchisors and sub-franchisors for misrepresentations contained in a disclosure document, although the extent and scope of such liability is contingent upon the applicable franchise legislation. Where a franchisor and a sub-franchisor are found liable for misrepresentations contained in a disclosure document, their liability will be of a joint and several nature.

Generally, the officers, directors and employees of a company cannot be sued in their personal capacity for the debts and obligations of the company. Accordingly, a key advantage presented by the subsidiary structure is the creation of a generally effective shield for the foreign franchisor seeking to avoid exposure to liabilities arising in Canada. Nevertheless, liability will not be entirely absorbed by the corporate subsidiary in those cases where a separate entity furnished a guarantee under the franchise agreement or breached its legal or statutory obligations in regards to the same.

The Canadian Franchise Acts extend liability for misrepresentations contained in a disclosure document to a much broader class of persons than those who would otherwise be liable under Canadian common law. Under the Alberta Act, a franchisee has a right of action not only against the franchisor, but also against every person who signed the misrepresentative disclosure document. Similarly, each of the other Canadian Franchise Acts provide that a franchisee may not only claim damages for misrepresentation from the franchisor, but also from the broker and associate of the franchisor as well as every person who signed the relevant disclosure document or statement of material change. In light of the very broad statutory construction given to the term 'franchisor's associate', the principal owner or controlling shareholders of a franchisor who are personally involved in the granting or marketing of the franchise may qualify as franchisor's associates. Similarly, parent companies of Canadian subsidiaries incorporated for the purpose of conducting franchise operations in Canada may also qualify as franchisor's associates where such parent companies participate in the review or approval of the granting of a franchise.

22 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 common-law 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.

23 Other than franchise-specific rules on what disclosures a franchisor should make to a potential franchisee or a franchisee should make to a sub franchisee regarding predecessors, litigation, trademarks, fees etc, are there any general rules on pre-sale disclosure that might apply to such transactions?

There is no such general obligation to disclose under the common law system in Canadian provinces. Nevertheless, the civil law applicable in the province of Quebec does contain general principles applicable to all contracts. Article 1375 of the Civil Code of Quebec establishes that the duty of the parties to conduct themselves in good faith also extends to pre-contractual negotiations and has generally been interpreted as imposing a positive obligation to inform the opposing party of any information which could affect its decision to enter into the contract. This diverges from the fair dealing provisions of the Canadian Franchise Acts that apply only in the 'performance and enforcement' of a franchise agreement.

The obligation to inform can be sanctioned in several ways depending on the situation. If the withheld information is sufficiently important that it would have caused the franchisee not to contract or to contract on different terms, the franchisee's consent is considered to have been vitiated, either due to error under article 1400 of the Civil Code of Quebec (if withheld inadvertently) or fraud under article 1401 (if withheld intentionally). In such cases, the franchisee can apply for annulment of the agreement and damages.

If the withheld information is not important enough to affect the validity of the contract, or if it is but the franchisee nevertheless prefers to maintain the agreement, the franchisee can simply claim damages or a reduction of its obligations set out in the franchise agreement equivalent to the damages to which it would otherwise be entitled.

24 What actions may franchisees take if a franchisor engages in fraudulent or deceptive practices in connection with the offer and sale of franchises? How does this protection differ from the protection provided under the franchise sales disclosure laws?

The rights conferred by each of the Canadian Franchise Acts are in addition to, and do not derogate from, any other right, remedy or recourse that a franchisee may have in law.

Judicial decisions emanating from the common law provinces reflect a general and growing affirmation of the common law duty of good faith in franchising, the substantive requirements of which will be conditioned by the specific set of circumstances surrounding the formation of the franchise agreement and the conduct of both parties. Where the courts find that there has been a breach of such duty of good faith, the franchisor may be found liable to the franchisee for its damages. Not every breach of such duty will constitute a fundamental breach of the franchise agreement, which fundamental breach would excuse the franchisee from future performance under the agreement.

In addition, pursuant to article 1401 of the Civil Code of Quebec, an error by a party induced by a fraud committed by the other party, or with its knowledge, will nullify consent whenever, but for the error, the misled party would not have contracted or would have contracted on different terms. It is important to note that in Quebec silence may amount to a misrepresentation. Such a fraud could be sanctioned with damages and annulment of the contract or, should the franchisee prefer to maintain the contract, a reduction of its obligations set out in the franchise agreement equivalent to the damages to which it would otherwise be entitled.

Legal restrictions on the terms of franchise contracts and the relationship between parties in a franchise relationship

25 Are there specific laws regulating the ongoing relationship between franchisor and franchisee after the franchise contract comes into effect?

Other than the Canadian Franchise Acts, there are no specific statutes directly affecting the franchise relationship.

26 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.

27 Do other government or trade association policies affect the franchise relationship?

No other government policies or requirements directly affect the franchise relationship.

28 In what circumstances may a franchisor terminate a franchise relationship? What are the specific legal restrictions on a franchisor's ability to terminate a franchise relationship?

There are no restrictions at law on the parties' rights to contractually establish termination rights and consequences arising upon termination. Nevertheless, courts may require that a material breach of the agreement be proven in order to permit its termination and will, from time to time, intervene to redress cases of abuse.

29 In what circumstances may a franchisee terminate a franchise relationship?

There are no rights at law that would specifically allow a franchisee to terminate the franchise relationship other than those applicable to all contracts under general principles of law and those expressly granted by the Canadian Franchise Acts. Similarly, there is no restriction precluding the parties from granting specific termination rights to a franchisee, although this is not often seen in typical franchise agreements used in Canada.

30 May a franchisor refuse to renew the franchise agreement with a franchisee? If yes, in what circumstances may a franchisor refuse to renew?

In Canada, a franchisor may refuse to renew a franchise agreement with its franchisee unless such renewal is contractually required. The franchisor may contractually subject such renewal to the signature by the franchisee of a new franchise agreement and other conditions, including performance goals that the franchisee is required to achieve.

31 May a franchisor restrict a franchisee's ability to transfer its franchise or restrict transfers of ownership interests in a franchisee entity?

A franchisor may contractually restrict a franchisee's ability to transfer its rights and interests under the franchise agreement, most notably by subjecting such transfer to the prior consent of the franchisor.

32 Are there laws or regulations affecting the nature, amount or payment of fees?

No general restrictions apply to payment of initial fees. Where franchises are involved in the sale of specifically regulated products or services, including liquor, medical or pharmaceutical products and services, however, a franchisor's ability to collect royalties on such sales may be restricted.

33 Are there restrictions on the amount of interest that can be charged on overdue payments?

Franchise agreements frequently set out the rates of interest charged on overdue fees and royalty payments. Section 347 of the Criminal Code (Canada) provides that anyone who enters into an agreement to receive interest, or who receives a payment or partial payment of interest, at an effective annual rate of interest (broadly defined) in excess of 60 per cent on the credit advanced, commits an offence thereunder.

In addition, section 4 of the Interest Act (Canada) specifies that unless the contract expresses the applicable rate of interest on an annualised basis, interest will only be recoverable at a rate of five per cent per annum despite the terms of the contract.

34 Are there laws or regulations restricting a franchisee's ability to make payments to a foreign franchisor in the franchisor's domestic currency?

A franchisee may be required to make payments in a foreign franchisor's domestic currency. Nevertheless, the Currency Act (Canada) precludes a Canadian court from rendering a judgment in any currency other than Canadian currency.

35 Are confidentiality covenants in franchise agreements enforceable?

Confidentiality covenants in franchise agreements are not only enforceable but highly advisable in light of the fact that recourse is only otherwise available under common law tort, as opposed to under any specific Canadian statute governing trade secrets or other confidential information. Confidentiality clauses can be for a longer duration than non-compete clauses.

36 Is there a general legal obligation on parties to deal with each other in good faith? If so, how does it affect franchise relationships?

The Canadian Franchise Acts impose a general obligation of fair dealing upon the parties to a franchise relationship.

It is established law in Canada that the relationship between a franchisor and a franchisee is generally not a fiduciary one. Nevertheless, Canadian courts (even in provinces without franchise legislation) have generally begun to read into franchise agreements an implied duty of simple good faith (as opposed to 'utmost good faith'). Good faith is a legal requirement in all contractual matters governed by Quebec civil law. Accordingly, the courts have stated that where the franchisor retains sole discretion to authorise, prevent or proceed with a particular course of action, the franchisor will have to exercise its discretion reasonably. In addition, the duty to act in good faith requires a prompt response to another party's request and the making of a decision within a reasonable period of time thereafter. Moreover, parties under a duty of good faith must also pay any amounts that are clearly owed to another party in a timely manner.

The duty to act in good faith does not necessarily preclude a franchisor from competing with its franchisee (assuming, of course, the absence of contractual exclusivity in favour of the franchisee). A franchisor that opts to compete with its franchisee must ensure that it continues to perform its legal obligations towards the latter and that it acts in such a way that the franchisee may continue to enjoy the benefits of its franchise. The common law principle of non-interference with the freedom of the parties to contract will often limit judicial interference in franchise agreements whose terms are found to accurately reflect the intent of the parties and are not patently inequitable. A determination as to whether a duty of good faith has been breached will be contingent upon all of the surrounding circumstances.

37 Does any law treat franchisees as consumers for the purposes of consumer protection or other legislation?

Consumer protection legislation in Canada has been enacted at the provincial level. The applicability of such legislation is generally restricted to transactions entered into for personal, family or household purposes and the legislation generally excludes from its ambit transactions entered into for business purposes. In a 2004 case before the Superior Court of Quebec, a franchisee sought to avail itself of protection under the Consumer Protection Act (Quebec) but was unsuccessful, the Court concluding that the tenor of the correspondence between the franchisee and the franchisor, as well as the nature of the franchise agreement, both clearly implied a commercial relationship falling outside of the scope of the legislation.

38 Must disclosure documents and franchise agreements be in the language of your country?

The Charter of the French Language (Quebec) compels businesses to prepare franchise agreements and disclosure documents in French for use in the Province of Quebec unless the parties have expressly agreed that another language may be used, which is not uncommon in circumstances where both parties are comfortable in such other language.

39 What restrictions are there on provisions in franchise contracts?

Franchise agreements often provide for exclusive territories and exclusive dealings with designated suppliers. These are not per se illegal, but are subject to competition law concerns relating to substantial lessening of competition and market barriers, including the exclusive dealings and abuse of dominance provisions of the Competition Act (Canada). Restrictions on the customers that the franchisee is entitled to serve may not be acceptable as they may be viewed as violating the market division prohibitions of the Competition Act or providing strong evidence of collusion pursuant to the same.

Resale price maintenance provisions set out in the Competition Act prohibit the franchisor from establishing a minimum price at which its products are sold. The mere suggestion of a minimum resale price by the manufacturer or the franchisor, other than on the labelling or packaging of the product, creates a presumption of violation of resale price maintenance provisions. All the same, franchisors may impose maximum prices as long as the latter are clearly referred to and defined in the franchise agreement and are not construed by courts as demonstrating an intent to establish an indirect minimum resale price. Accordingly, it is always prudent for franchisors to include disclaimers, whether in advertising or on packaging, to the effect that franchisees are at liberty to establish their own resale prices. Furthermore, it is preferable to contractually provide

Update and trends

In March 2013, the British Columbia Law Institute issued a consultation paper recommending that a franchise act be enacted in the Province of British Columbia. The British Columbia Law Institute is seeking the opinions of franchisees, franchisors, businesses, consumer protection centric organisations and the public. Responses and recommendations must be submitted to the British Columbia Law Institute on or prior to 30 September 2013. Following that deadline, the consultation paper, as amended if such is the case, will be submitted to the British Columbia legislature for potential enactment. The British Columbia Law Institute has recommended that British Columbia enact franchise legislation based on the Uniform Franchises Act (other than in respect of its dispute resolution provisions insofar as same relate to mandatory mediation). The franchise legislation in the Province of Alberta and Ontario provided the foundation for the Uniform Franchises Act, which in turn greatly influenced the franchise legislation enacted in New Brunswick, Prince Edward Island and Manitoba. If a franchise act is enacted subsequent to these recommendations, British Columbia would be the sixth province in Canada to have franchise legislation.

that prices are only suggested and that the failure of the franchisee to adhere to the suggested prices will not result in termination of the franchise agreement or detrimentally affect the relations between the parties.

Franchisors who are deemed to control a market are also subject to review by the Competition Bureau under the abuse of dominance provisions in the Competition Act. As of 2009, the criminal pricing provisions addressing price discrimination, predatory pricing, geographic price discrimination and promotional allowances have been repealed with a view to promoting innovative pricing programmes and increasing certainty for Canadian businesses. Nonetheless, such pricing policies may be reviewed under civil provisions of the Competition Act where there is evidence of a likely substantial anti-competitive effect.

Non-competition covenants are closely monitored by the courts. All restrictive covenants raise restraint of trade concerns and, accordingly, only reasonable restrictions as to scope of action (described with sufficient particulars), duration and geographical reach will be upheld by the courts. Canadian courts will generally not write down or reduce restrictive covenants determined to be unreasonable, but will uphold or strike down the covenant in its entirety.

Lastly, all Canadian provinces permit the selection of a foreign governing law as long as doing so is not considered to be in fraud of the domestic law. That said, Canada is party to numerous international treaties such as the Vienna Convention on the International Sale of Goods – where the selected or applicable law is that of Canada, the foregoing Convention finds automatic application unless expressly set aside by the parties in their contract.

40 Describe the aspects of competition law in your country that are relevant to the typical franchisor. How are they enforced?

The Competition Act sets forth penal and civil recourses with respect to various practices, including those identified as conspiracies and collusion, abuse of dominance, price maintenance, promotional allowances and price discrimination, misleading advertising, deceptive marketing and pyramid selling, refusal to deal, exclusive dealing, tied selling, as well as certain other vertical market restrictions.

While the penal provisions of the Competition Act impose a higher burden of proof, their violation grants injured parties the right to sue for damages caused by such practices; those damages are restricted to actual loss and costs. On the other hand, reviewable practices are civil in nature and are subject to the exclusive jurisdiction of the Competition Tribunal, upon the request of the commissioner of competition or, as of late, at the request of a private party with leave from the Competition Tribunal to that effect. In this latter case, it should be noted that private litigants may only seek redress through orders as monetary awards are not provided for.

The commissioner of competition heads the Competition Bureau and has broad powers of investigation and inquiry, such as search and seizure, examinations under oath, and ordering the production of physical evidence or records and wire tapping (in certain circumstances). Its enquiries are conducted under strict rules of confidentiality and its powers remain subject to the supervision of the courts. On the international level, the Competition Bureau has concluded numerous agreements of notification and mutual assistance with its international counterparts and is an active member of the International Competition Network.

41 Describe the court system. What types of dispute resolution procedures are available relevant to franchising?

The Constitution Act, 1867 sets out the areas of law with respect to which the federal government has the power to legislate (for example, intellectual property, bankruptcy, trade and commerce) and the areas of law with respect to which each provincial government has the power to legislate within provincial borders (eg, property and civil rights). Canada also has a dual court system. The Federal Court of Canada has jurisdiction over matters in respect of which jurisdiction as to subject matter is specifically conferred to it by statute, whereas the provincial courts have residual jurisdiction over remaining matters.

Choice of forum clauses are generally enforced by the Canadian courts, thus making it possible for the parties to choose that a non-Canadian court resolve any dispute or claim arising from any agreement. In addition, mediation and arbitration are viable and recognised mechanisms of dispute resolution across Canada. Furthermore, Canada is a signatory party to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards. Both the federal and the provincial governments have also adopted substantially similar legislation to the UNCITRAL Arbitration Model Law. To date, three provinces (Ontario, British Columbia and Saskatchewan) have incorporated mandatory pre-trial mediation into their respective procedural statutes, and most provinces have enacted arbitration legislation.

42 Describe the principal advantages and disadvantages of arbitration for foreign franchisors considering doing business in your jurisdiction.

The principal advantages and disadvantages of arbitration for foreign franchisors in Canada are essentially the same as for local franchisors.

Arbitration has the main advantage of being confidential. Disputes between franchisors and franchisees do not become a matter of public record as would be the case with litigation in the judicial system. In addition, arbitration gives the parties a level of control which they may not otherwise have over some aspects of the dispute, such as choice of venue and forum and the selection of an arbitrator with expertise in franchise issues or the relevant technical or specialised fields. Arbitration agreements are final, reliable and not open to appeal; Canadian courts have generally refrained from intervening in such decisions. Finally, arbitration tends to be faster and cheaper than litigation, at least in theory.

As for its disadvantages, arbitration, like litigation, can become bogged down procedurally, diminishing the cost and time savings

which often motivate its use. The lack of ability to appeal heightens risk for the parties that have no recourse against a bad decision. Some also argue that arbitration clauses which preclude access to the judicial system will prevent the use of proceedings such as injunctive or other equitable relief that can be obtained quickly to effectively end a breach of contract.

43 In what respects, if at all, are foreign franchisors treated differently from domestic franchisors?

There is no legal discrimination or heightened level of legal requirements for foreign franchisors. Nevertheless, depending on the vehicle they choose through which to export their franchises to Canada, foreign franchisors may find themselves subject to a different taxation regime than would domestic franchisors, and subject to certain notice requirements under the Investment Canada Act. As a practical matter, franchisees may be more hesitant to enter into a franchise agreement, particularly one where the obligations of the franchisor (for example, training, advertising) are numerous, in circumstances where the franchisor has no domestic presence of note.

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