

T: FRANCHISE LAW

OLYMPIC STADIUM, MONTREAL

Canada has been host to multiple Olympics, the World's Fair, the Pan Am and Parapan Am Games, and other international events during the last century.

- > **With a vibrant economy and close proximity to the United States, Canada is the natural first destination for U.S. franchise companies seeking to expand internationally.**

There are approximately 1,300 franchise brands and over 78,000 franchise units operating throughout Canada, crossing almost 50 different sectors of the economy, including retail, hospitality, automotive and health care — accounting for one out of every five consumer dollars spent in Canada on goods and services, and approximately \$100 billion in annual sales.

While Canada is an attractive destination for international expansion, franchisors must be aware of the franchise-specific disclosure laws currently in effect in five of the Canadian provinces.

1. FRANCHISE DISCLOSURE LEGISLATION

The provinces of Alberta, Ontario, New Brunswick, Prince Edward Island and Manitoba have each enacted franchise disclosure legislation. The rights and obligations under the franchise legislation of these five provinces are very similar, with the general aim being to regulate the franchise marketplace and to protect both prospective franchisees and those already party to a franchise relationship. The law is remedial and is intended to address the perceived imbalance of power in the franchisor-franchisee relationship. It adopts three key principles:

- The obligation imposed on franchisors to provide disclosure
- The duty of good faith and fair dealing imposed upon franchisors and franchisees
- The right of franchisees to associate

Failure to comply with any of these obligations gives rise to significant remedies for franchisees. Furthermore, a franchisee cannot contract out of the rights granted to it or grant a waiver of the obligations imposed on franchisors under the legislation.

The franchise legislation in the five provinces also deems unenforceable any provision in a franchise agreement that restricts the application of the laws of the province, or that restricts the jurisdiction or venue to a forum outside of the province with respect to claims enforceable under that province's franchise legislation.

On April 2, 2013, the British Columbia Law Institute (BCLI) issued the Consultation Paper on a Franchise Act for British Columbia (Consultation Paper) to examine whether B.C. should enact franchise legislation. The Consultation Paper included a recommendation that B.C. should enact disclosure-only legislation, which would be similar to that of the five other provinces that have franchise legislation. Draft legislation has not yet been introduced by the province of British Columbia.

2. THE DISCLOSURE OBLIGATION

A franchisor wishing to grant a franchise in any of the five provinces noted above must provide the prospective franchisee with a disclosure document at least 14 days before the earlier of either: (i) the signing of the franchise agreement, or any agreement relating to the franchise, by the prospective franchisee, or (ii) the payment of any consideration relating to the franchise.

A disclosure document must contain all of the information prescribed by the regulations, as well as all other "material facts" (as discussed below) that would reasonably be considered relevant to a prospect's decision to acquire the franchise. The disclosure document must also contain the franchisor's financial statements in either audited or review engagement form. Large, mature franchisors may be exempt from the requirement to include financial statements if they meet certain criteria.

a. Material facts

"Material fact" is broadly defined to include any information about the business, operations, capital or control of the franchisor or franchise system that would reasonably be expected to have a significant effect on the value or price of the proposed franchise, or on the decision to acquire the franchise.

The requirement for disclosure of additional information to that specifically prescribed by the provincial legislation has led to some of Canada's most significant franchise-related court decisions. As a result, disclosure documents must, in many circumstances, be customized to include information applicable to the actual subject matter or location of the proposed franchise.

b. Certification

A disclosure document must be certified as complete disclosure in accordance with the applicable provincial statute. A signed and dated certificate is not a mere formality but a mandatory requirement. Failure to provide a proper certificate will result in a determination that no disclosure was provided to the franchisee.

The certificate must be signed and dated in the manner prescribed by the applicable provincial statute. In particular, an incorporated franchisor must ensure that the certificate is signed by two officers or directors of the franchisor (or one, if there is only one). It must be signed by them personally and not on behalf of the franchisor.

c. Remedies

Franchise legislation has been broadly interpreted by the courts to ensure that the purpose of the legislation is met and that a prospective franchisee is provided with the information necessary to make an informed decision.

In the event of a franchisor's failure to comply with its disclosure obligations, there are two separate remedies available to a franchisee: rescission and claims for misrepresentation.

A franchisee can rescind a franchise agreement when a franchisor fails to properly comply with the disclosure requirements. Following a valid rescission, the franchisor is obliged to put the franchisee back into the position it had been in prior to the purchase of the franchise. A franchisor faced with a rescission claim is required to:

- Refund all monies paid to the franchisor by the franchisee
- Purchase all inventory, equipment and supplies bought by the franchisee pursuant to the franchise agreement at the price paid by the franchisee
- Compensate the franchisee for all losses incurred to establish and operate the franchise

Two separate time periods are available to a franchisee to rescind: (i) no later than 60 days after receiving the disclosure document, if the disclosure document did not comply with the delivery requirements of the legislation or if the contents of the disclosure document did not meet the legislation's requirements, and (ii) no later than two years after entering into the franchise agreement, if the franchisor never provided the disclosure document.

The courts' interpretation of the rescission remedy has blurred these two time periods by holding that a materially non-compliant or deficient disclosure document is no disclosure at all. As a result, strict compliance with the delivery requirements and the prescribed contents of a disclosure document is a necessity. The provision of a generic "standard form" disclosure document will not suffice to protect a franchisor from claims of non-compliance — particularly in cases where additional material information regarding the proposed franchise is known to the franchisor and is not fully disclosed.

In addition to the rescission remedy, franchisees have the right to bring a claim for damages for misrepresentations made in the disclosure document or for a franchisor's failure to comply with the disclosure requirements. Accordingly, if a franchisee misses the time period for rescission, it can still seek damages for breach of the disclosure obligation.

Claims for misrepresentation can be made against not only the franchisor, but also against individuals, including any director or officer of the franchisor who signed the certificate of disclosure. "Misrepresentation" is defined broadly to include an omission, and a franchisee is deemed to rely on a misrepresentation in a disclosure document and on the information contained in the disclosure document provided.

3. THE DUTY OF FAIR DEALING

Franchise legislation in Canada imposes on all parties to a franchise agreement a duty of fair dealing in the performance and enforcement of the agreement. This includes the duty to act in good faith and in accordance with reasonable commercial standards.

The courts have interpreted the duty of fair dealing to require that the franchisor enforce the franchise agreement in a manner that takes into account the interests of the franchisee (but not to the exclusion of the franchisor's interests) without malice or ulterior purpose. In effect, the obligation imposes limitations on a franchisor's discretion in enforcing its strict contractual rights where such exercise negatively impacts the interests of the franchisee. A breach of the duty of fair dealing is imposed on both the franchisor and a franchisee, and entitles the non-breaching party to claim damages for the breach.

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4. THE RIGHT OF ASSOCIATION

Franchisees have the right to associate with other franchisees and to form or join an organization of franchisees without penalty or interference from the franchisor. Any provision in a franchise agreement that restricts this right is void, and a franchisee has a right of action against the franchisor for breach of this right. The right of association has been used by the courts to protect a franchisee's right to participate in a class action.

5. RIGHTS CANNOT BE WAIVED

Under the franchise legislation, rights given to a franchisee and obligations imposed on a franchisor cannot be waived. Accordingly, a release by the franchisee as a condition to the franchisor's consent to a renewal or transfer of its franchise must expressly exclude rights and obligations imposed by the legislation.

Therefore, the applicable provisions in the franchise agreement requiring a release by the franchisee on renewal or transfer must expressly state that the release excludes these rights and obligations — or the condition requiring delivery of the release will be rendered void. However, the courts will uphold a release given by a franchisee of existing known claims as part of the negotiated settlement of a dispute.

6. PROVINCE OF QUÉBEC

The province of Québec is a civil law jurisdiction. While Québec has no franchise-specific legislation, both the *Civil Code of Québec* and the *Québec Charter of the French Language* apply to franchising.

Québec's *Civil Code* contains provisions governing "contracts of adhesion," which include franchise agreements and other standard-form agreements of a franchisor. One interesting provision states that any terms of a contract that are not fully known to a party, such as a franchisee, at the time of signing will not be enforceable. This could affect the usual franchise agreement term that requires franchisees to comply with the operations manual, and would require franchisors to arrange for a confidential disclosure of the manual to a franchisee before the agreement is signed.

The *Civil Code* also contains a statutory duty of good faith. This duty is broader than the duty of fair dealing included in the provincial franchise legislation, as it applies to the negotiation as well as the performance and enforcement of franchise agreements.

The Québec *Charter of the French Language* mandates French as the required language of doing business in Québec and in the workplace in Québec. "Doing business" applies to forms, advertising (including websites), posters and signs. In addition, if a French version of a trademark has been registered, it must be used.

While this typically results in the equal use of French and English, there are some provisions, such as those governing the use of signs and posters, where the use of the French language must be "markedly predominant." This usually means a French-to-English ratio of two-to-one in size of wording or number of items.

In the workplace, working documents must be available in French, including software if French-language versions exist.

Franchising is a significant and well-recognized means of doing business in the province of Québec, and although there are specific laws intended to preserve and entrench the French language in the province, they are usually not difficult to comply with.