

Franchising in Canada: overview

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MARKET

1. What have been the main developments in the franchising market over the past 12 months?

The acquisition of the iconic Tim Horton's franchise chain of fast food restaurants, with its 3,588 units, by Burger King (which is in turn owned by 3G Capital) was clearly the most significant business development in the Canadian franchise marketplace in the past 12 months. We do not see a great number of acquisitions of larger franchise systems in Canada, partly because there are relatively few large franchise systems in Canada. Nonetheless, with the aging Canadian population and the expected dramatic increase in the number of retiring franchisors, the volume of mergers and acquisitions of Canadian franchise systems is anticipated to increase significantly in the near future.

Unfortunately, there is no hard data on the number of Canadian franchise systems expanding outside of Canada or the number of foreign franchise systems entering the Canadian market. However, for those immersed in the franchise sector, it is common knowledge that the march of US franchisors coming north to Canada is steadily increasing, as it has been for the last 15 years or more. More recently, we are seeing more and more Canadian franchise systems expanding to the US and beyond, and an increase in franchise systems from outside of North America coming to Canada. The globalisation of franchising has been a steady and growing trend.

Canada, with its close proximity and similarity to the massive US franchise market, a stable and reliable economy, high per capita personal incomes and vibrant franchise marketplace, has made Canada the gateway to North America for many franchise systems from around the world.

At the beginning of 2013, the Canadian Franchise Association identified six sectors of franchises that have grown significantly over the past five years (Canadian Franchise Association, "What are the Hot Trends in Franchising for 2013?", 7 January 2013, see: www.cfa.ca). Over that period:

- Business consultants/services/training saw an increase in franchise listings of 211%.
- Hair and nail salons/spas saw an increase in franchise listings of 188%.
- Seniors/home care and services saw an increase in franchise listings of 121%.
- Food/restaurants/dining rooms saw an increase in franchise listings of 88%.
- Home-based businesses saw an increase in franchise listings of 83%.
- Health and fitness saw an increase in franchise listings of 82%.

According to the Canadian Franchise Association's website:

- The Canadian franchise industry generates approximately CAD68 billion every year.
- Over one million Canadians (approximately one out of every 14 working Canadians) are directly or indirectly employed by the franchise industry.
- There are over 78,000 franchise units across Canada.
- Over 60% of franchises can be found in non-food sectors and industries.
- There are an estimated 1,300 franchise brands operating in Canada.

Another important development in Canada (and particularly Québec) was the end of a lengthy legal battle following the decline of the Dunkin' Donuts franchise in Québec, which was largely attributable to the success and increased market share acquired by Tim Hortons. Québec courts have imposed more onerous obligations on franchisors to protect and enhance their brands' reputation and the overall demand for their branded products, and determined that the obligation to support franchisees is implicit in the franchise agreement and is an integral part of the fundamental nature of the franchise relationship itself.

2. What are the most commonly used methods of local and international franchising?

Local franchising

Historically, the most common franchise vehicle used in Canada has been direct franchising of a single franchise to a single franchisee. However, Canada is following the trend started many years ago in the US, which involves granting multiple franchise rights to a single franchisee entity. Sometimes this occurs as a result of multiple grants over several years as the franchisee proves it is worthy, and sometimes this occurs as a result of a negotiated development agreement where the franchisor and the franchisee agree on a specific number of units, to be opened within a specified timeframe, within a certain territory.

Master franchising is not commonly used domestically in Canada, but there are examples of its use, particularly from region to region, or province to province, as Canada has pockets of population spread over a vast geography. It's frequently used for expanding a franchise system into, or out of, the province of Québec, owing to Québec's linguistic and cultural differences from the rest of Canada.

International franchising

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 choice of vehicle depends on various factors and can include the incorporation of a Canadian subsidiary, the use of a Canadian branch or division, or directly contracting through a foreign entity. Using a subsidiary in Canada often has the added benefit of establishing a physical presence locally and publicly indicates a commitment to the local market in addition to providing for segregation of liability and accounting.

Various contractual structures are also possible, and direct franchising, master franchising and joint ventures are commonly used by foreign franchisors in Canada.

Historically, Canadian franchise systems have not been so adventuresome beyond the borders of Canada. This may be due in part to the conservative nature of Canadian business people, and in part because Canadian systems tend to be relatively smaller in size, with fewer economic and human resources, to take on an international expansion. One glaring exception is expansions to the US. The US is constantly beckoning Canadian franchise systems, because it is familiar, close and similar to Canada. Unfortunately, in the past, Canadian franchise systems have not fared well in the US, often because the Canadian franchisor saw the similarities to the Canadian market, but did not grasp the differences, which are often subtle but profound.

At present, there are strong signs that Canadian franchisors are beginning to wake up to international opportunities and are learning how to be successful in the tougher US market and beyond.

3. Are there any specific reasons for an overseas franchisor to use a separate entity for entering into a franchise agreement with a franchisee in your jurisdiction?

There are no specific reasons for an overseas franchisor to use a separate entity for entering into a franchise agreement with a franchisee in Canada.

REGULATION OF FRANCHISING

4. What is the legal definition of franchising and/or a franchise?

Franchising is a right to engage in business for which the franchisee is required to directly or indirectly make, or commit to make, a payment (or continuing payments) to the franchisor (or the franchisor's associate) in the course of operating a business, or as a condition of acquiring the franchise or commencing operations, and in which either:

- The franchisor grants the franchisee the right to sell goods or services substantially associated with the franchisor's trade mark. The franchisor exercises significant control over, or offers significant assistance in, the franchisee's method of operation.
- The franchisor grants the franchisee the representational or distribution rights to sell or distribute goods or services supplied by the franchisor, or a supplier designated by the franchisor. The franchisor or a third person designated by the franchisor provides location assistance.

5. What are the laws regulating franchising?

Franchising is provincially regulated. Currently, Alberta, Manitoba, New Brunswick, Ontario and Prince Edward Island have franchise legislation in force. British Columbia has recently passed franchise legislation for which regulations are being developed.

Canadian franchise legislation is remedial and is intended to level the perceived imbalance of power in a franchisor/franchisee relationship. Canadian franchise legislation, among other things:

- Imposes upon each party a duty of fair dealing in the performance and enforcement of the franchise agreement and, with the exception of Alberta, a duty to act in good faith and in accordance with reasonable commercial standards. A breach of such duty provides the innocent party with a right of action for damages.
- Entitles a franchisee to associate with other franchisees and to form or join an organisation of franchisees. A franchisee has a right of action for damages against a franchisor that tries to penalise its franchisees from associating/organising.
- Requires a franchisor to provide a prospective franchisee with a disclosure document before the prospective franchisee signs the franchise agreement or makes any payment to the franchisor. Canadian franchise legislation specifies the:
 - contents of the disclosure document;
 - method of delivery;
 - time requirements; and
 - exemptions from the obligation to disclose.
- Allows a franchisee to rescind the franchise agreement if the franchisor failed to provide a disclosure document (or statement of material change) within the time required, or if the contents did not meet the requirements, or if the franchisor never provided the disclosure document.
- Entitles a franchisee to a right of action for damages if a franchisee suffers a loss because of a misrepresentation contained in the disclosure document (or statement of material change).
- Includes an anti-waiver provision which deems any purported waiver or release by a franchisee of a right given under the applicable Act to be void.

While there is no specific franchise law in the province of Québec, the Civil Code of Québec contains provisions applicable to all contracts governed by Québec law, including franchise agreements.

6. What is the regulatory authority responsible for enforcing franchising laws and requirements in your jurisdiction?

Franchising laws and regulations are enforced by private action and not by government agencies. However, the Canadian Franchise Association (CFA) does require its members to adhere to the CFA code of ethics (a copy of which can be found at: www.cfa.ca/about-our-members/cfa-code-of-ethics/). The CFA website also provides a list of all members that are in good standing and voluntarily agree to adhere to the CFA code of ethics. The CFA is the only national trade association serving the franchise industry in Canada, and membership is voluntary.

7. Must the franchisor be registered with a professional or regulatory body before setting up a franchise system?

There is no registration requirement for establishing a franchise in Canada. More particularly, there is no requirement for registration before a franchisor can offer franchises for sale, and there is no

requirement that disclosure documents or marketing materials be registered. There are no requirements that:

- A franchisor must be in business for any specified period of time.
- A franchisor must operate a minimum number of corporate locations.
- A franchisor has conducted its business in Canada for any requisite period.

A franchisor can become a member of the Canadian Franchise Association, although membership is voluntary.

8. Is there a code of ethics or other means of promoting ethical franchising in your jurisdiction?

The Canadian Franchise Association (CFA) requires its members to adhere to the CFA code of ethics (a copy of which can be found at: www.cfa.ca/about-our-members/cfa-code-of-ethics/). The general obligations under the code are summarised as follows:

- Members must fully comply with federal and provincial laws, and with the policies of the CFA.
- Franchisors must provide prospective franchisees with full and accurate written disclosure of all material facts/information within a reasonable time.
- All matters material to the franchise relationship must be contained in one or more written agreements.
- A franchisor should select and accept only those franchisees that possess the basic skills, education, personal qualities and financial resources adequate to perform under the requirements of the franchise without any discrimination.
- A franchisor must provide reasonable guidance, training, support and supervision over the business activities of franchisees.
- Fairness must characterise all dealings between a franchisor and its franchisees.
- A franchisor and its franchisees must make reasonable efforts to resolve grievances and disputes through fair/reasonable direct communication and through alternative dispute resolution.
- Members must encourage prospective franchisees to seek legal, financial and business advice prior to signing the franchise agreement.
- A franchisor must encourage prospective franchisees to contact existing franchisees to gain a better understanding of the requirements and benefits of the franchise.
- A franchisor must encourage open dialogue with franchisees through franchise advisory councils and other communication mechanisms.
- Members that provide products or services to a franchisor or franchisee must encourage the franchisees to comply with the spirit of this code of ethics.

The European Code of Ethics has not been adopted in Canada.

9. Do franchisees benefit from any laws designed to protect consumers or small businesses?

Consumer protection laws in Canada are enacted by the provinces, and apply to retail and personal transactions. Business transactions (including franchises) are expressly excluded from

their remit. Contractual relations between a franchisor and a franchisee are generally considered business transactions in Canada.

10. Are there any other requirements which must be met before a business can sell a franchise?

Apart from compliance with general principles of law (for example, concerning contract formation), and the franchise specific provincial statutes and regulations, there are no other legal requirements that must be satisfied before a business can sell a franchise.

FRANCHISE AGREEMENT

Pre-contract disclosure requirements

11. Is the franchisor subject to any general or formal pre-contract disclosure requirements?

A franchisor must provide a prospective franchisee with a disclosure document containing all required information contained in one document and delivered at one time at least 14 days before the earlier of either:

- The signing by the prospective franchisee of the franchise agreement or any other agreement relating to the franchise.
- The payment of any consideration relating to the franchise.

Delivery methods are prescribed.

The disclosure document must contain:

- All material facts.
- Financial statements and other financial information.
- Copies of all proposed franchise agreements and other agreements relating to the franchise to be signed by the prospective franchisee.
- Statements as prescribed for the purposes of assisting the prospective franchisee in making informed investment decisions.
- Other information and copies of documents as may be prescribed (business background of the franchisor, directors, general partners and officers of the franchisor, operational information, and so on).

If a prospective franchisee has received a disclosure document but has not yet signed a franchise agreement or paid any consideration, the franchisor must provide a prospective franchisee with a written statement of any material change. A statement of material change must be delivered as soon as practicable after the change has occurred and before the earlier of either:

- The signing of any franchise agreement.
- The payment of any consideration.

There are certain exemptions from the requirement to deliver a disclosure document. Such exemptions can be found in each province's franchise legislation.

A franchisee has a right of action for damages if a franchisee suffers a loss because of a misrepresentation contained in the disclosure document or the statement of material change.

A franchisee can rescind the franchise agreement within 60 days of receiving the disclosure document if the contents of the disclosure document do not meet the disclosure requirements. A franchisee can rescind the franchise agreement if the franchisor fails to provide the disclosure document or a statement of material change within the time requirements.

A franchisee can rescind the franchise agreement within two years after entering into the agreement if the franchisor never provided a disclosure document, or if there are deficiencies so material that the disclosure document is considered not to be a disclosure document at all.

In Québec, the general duty of good faith in contract is established by the Civil Code of Québec and extends to pre-contractual negotiations. The obligation of pre-contractual good faith has been interpreted as imposing a positive obligation to inform a counterparty of any information which could affect its decision to enter into a contract, including a franchise agreement. In particular, the courts have interpreted the civil law's general duty of good faith as imposing an obligation on franchisors to inform potential franchisees of any information in their possession that may have a decisive influence on the franchisee's decision to enter into the contract.

Failure to inform a franchisee of information in the franchisor's possession can be sanctioned in many ways depending on the circumstances. If information is withheld from the franchisee that is sufficiently important that its disclosure would have caused the franchisee not to contract, or to contract on different terms, then the franchisee's consent will be considered to have been vitiated either due to error (if withheld inadvertently), or due to fraud (if withheld intentionally). In such an event, the franchisee may be in a position to have the franchise agreement annulled and may apply for damages. If the information is not important enough to affect the validity of the contract, or if it is but the franchisee nevertheless prefers to maintain the franchise agreement, the franchisee could resort to claiming damages or a reduction of its obligations set out in the franchise agreement.

12. Must the franchisor disclose fairly and in good faith all facts material to the prospective franchisee's decision to enter into the arrangement, or must the prospective franchisee rely on its own due diligence?

A franchisor must provide a prospective franchisee with a disclosure document containing all material facts. Material facts are only those facts about the business, operations, capital or control of the franchisor (or franchisor's associate), or about the franchise or the franchise system, that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted, or the decision to acquire the franchise.

In addition, franchise legislation imposes upon each party a duty of fair dealing in the performance and enforcement of the franchise agreement and, with the exception of Alberta, a duty to act in good faith and in accordance with reasonable commercial standards.

See *Question 11* regarding good faith and disclosure in Québec.

Formalities

13. What are the formal contractual requirements to create a valid and binding franchise agreement?

A franchise agreement is similar to a trade mark agreement and service agreement, but it is generally a commercial agreement and subject to all of the rules of contract. Franchise legislation defines a franchise agreement to mean any agreement that relates to the franchise between a franchisor (or franchisor's associate) and franchisee, and it is not required to be registered anywhere in Canada. A franchise agreement can be written in English anywhere in Canada, including for use in the province of Québec, provided where it is for use in Québec, the parties have expressly agreed that language other than French will be used and wording is added to the following effect: "The parties to this agreement acknowledge having required that this agreement as well as all notices,

documents or agreements related to this agreement be drafted in English. *Les parties aux présentes reconnaissent avoir exigé que la présente convention ainsi que tous avis, documents ou ententes s'y rapportant soient rédigés en Anglais*".

Parties' rights and obligations

14. Is there a general obligation to behave fairly, reasonably or in good faith to the other party during the term of the franchise agreement?

Franchise legislation imposes upon each party to a franchise agreement a duty of fair dealing in the performance and enforcement of the franchise agreement and, with the exception of Alberta, a duty to act in good faith and in accordance with reasonable commercial standards. While franchise legislation imposes such a duty of fair dealing and good faith, a franchise relationship does not amount to a fiduciary duty as between the parties. The statutory duty of fair dealing and good faith cannot be overridden by provisions in a franchise agreement. The common law, in addition to the requirements of the provincial franchise statutes, imposes on the parties a duty of fair dealing.

Furthermore, the fundamental principles of good faith and honesty in contractual performance were recently recognised by the Supreme Court of Canada as applying to all contracts, including franchise agreements. However, the specific obligations arising from these principles must be analysed and determined in light of the nature of a given contract and the obligations that flow from it. Given that franchisees are often viewed as vulnerable parties and that franchise arrangements are generally considered long-term partnerships which require mutual co-operation and consideration, these obligations may have an impact on the manner in which franchisors and franchisees exercise their contractual rights and obligations. Vulnerable contractual parties have often been given special consideration under the common law, and common law courts may consider this central factor in interpreting the scope of the duties to act honestly and in good faith as they apply to franchisors and franchisees.

In Québec, a more fulsome obligation exists under the Civil Code of Québec which imposes a legal duty on all parties to conduct themselves in good faith during contractual dealings. Consequently, the courts have determined that where the franchisor retains sole discretion to authorise, prevent or proceed with a particular course of action, the franchisor must exercise its discretion reasonably. In addition, as confirmed recently by the Québec Court of Appeal, the general obligation of good faith may result in certain obligations applicable to the franchise relationship being implied into the franchise agreement. Implied obligations have included the franchisor's duty to support its brand and to take active measures that are consistent with this duty throughout the term of the franchise agreement.

15. Does local law require that particular provisions must be expressly included in a franchise agreement?

There is no rule of law or statute that dictates the content of a franchise agreement.

16. Are exclusion and entire agreement clauses enforceable in your jurisdiction? If so, are they effective to protect the franchisor?

Entire agreement clauses are generally enforceable in Canada. However, Canadian courts award remedies in connection with pre-contractual representations on the basis of collateral warranty. As

such, a foreign entire agreement provision should be modified to deal with the concept of collateral warranty.

In determining whether to enforce an exclusion clause, Canadian courts will inquire as to whether:

- The exclusion clause applies to the circumstances.
- The exclusion clause was unconscionable at the time the contract was made.
- The exclusion clause should be refused if there exists an overriding public policy that outweighs the public interest in the enforcement of contracts.

In Québec, courts enforce the legal obligation for parties to conduct themselves in good faith during pre-contractual phases and sanction conduct that is inconsistent with that principle.

17. Can the franchisor impose product tying or other purchasing restrictions and non-compete obligations on the franchisee during the term of the agreement?

Restrictions on purchasing and product tying

A franchisor can establish an approved supplier programme to control the quality and uniformity of certain products and services that are necessary to the franchise system.

Non-compete obligations and transfer restrictions

A non-competition covenant will be void unless it is reasonable. To be reasonable, a non-competition covenant:

- Must protect the franchisor's proprietary interest.
- Must not be broader in geographical area, time period or scope than is necessary to effectively protect the franchisor's interests.

A Canadian court will not re-write or write down or otherwise modify a non-competition covenant in order to make it reasonable and enforceable, but will either uphold or strike down the covenant in its entirety.

Fees and payments

18. What fees are usually payable by the franchisee? Are there any restrictions on the parties' freedom to set the fees and payments, or any other payment requirements?

It is most common for the royalties payable by franchisees to franchisors to be expressed as a percentage of gross revenue of the franchisee. Where products are involved, such as in the restaurant sector, the majority of franchise royalty rates will be between 4% and 8%. Where the business being franchised is for services, the royalty rate is often between 10% and 15%. Sometimes, the royalty rate will fall outside of these parameters, for specific reasons.

Almost all franchise offerings in Canada require the payment of an initial franchise fee. Often this fee is, at best, compensatory to the franchisor for what the franchisor provides to make a franchisee operational, including such things as:

- Searching out a location or territory.
- Negotiating a lease.
- Training the franchisee.
- Assisting with the build out.
- "Handholding" the franchisee through the first few months of operations.

Rarely does the initial franchise fee generate a true profit for the franchisor.

Many Canadian franchisors require franchisees to contribute to a regional and/or national advertising fund at a rate of between 1% and 3% of the franchisee's gross revenues. Usually, the franchisor administers such a fund, and some have franchisee advisory councils to obtain input from franchisees regarding use of the fund. Additionally, it is common for Canadian franchisors to require their franchisees to spend between 1% and 2% of gross revenues on local advertising. Sometimes, the advertising contribution rate will fall outside of these parameters, for specific reasons.

There are no laws in Canada that restrict or mandate any particular royalty amount or rate, or advertising contribution amount or rate, for such payments by franchisees. However, where franchises are involved in the sale of specifically regulated products or services, such as liquor, medical or pharmaceutical products and services, the franchisor's ability to collect royalty payments may be regulated.

Other than the Criminal Code maximum interest rate of 60%, there is no restriction on the rate or amount of interest charged by franchisors on amounts owed by franchisees.

Term of agreement and renewal

19. Are parties free to agree on the term of the franchise agreement? What is the typical term of a franchise agreement in your jurisdiction?

The parties to a franchise agreement are free to contract for any duration of the term of the franchise agreement and the number of renewals they wish. A franchise agreement in Canada can even be perpetual or perpetually renewable, although this is not common.

In Canada, the term (including all renewal terms) of a unit franchise agreement will usually be from five to 15 years, with longer or shorter terms depending upon the specifics of the situation. If the business being franchised is in the retail sector, it is common for the lease of the business premises and the franchise agreement to be co-terminus.

20. What rights of renewal are usually included in the franchise agreement? Are fees paid on renewal?

Commercial practice

It is common practice for the term of the franchise agreement to be broken into a shorter initial term, with one or several renewal options in the franchisee's favour. Often, there will be several criteria that must be met by the franchisee in order to exercise each renewal option, including, among other things:

- There are no breaches of the franchise agreement at the time of the renewal.
- The franchisee's ability to stay in the premises.
- Any necessary renovation of the premises to meet current standards is made.
- The payment of a renewal fee.
- The franchisor sometimes contractually requires a franchisee to sign a new form of franchise agreement possibly with different provisions.

The parties are free from any legal restrictions or requirements in setting renewal fees. Franchisees in Canada do not have any automatic legal right to renew a franchise agreement, other than the rights negotiated in the franchise agreement. The franchisor's primary goal is to set the renewal fee at a level that compensates

the franchisor for any costs that are incurred through the renewal process, which can result from, among other things:

- Inspecting the premises.
- Amending agreements.
- Reviewing the financial circumstances of the franchisee.

Local law

If a franchisee complies with all of the conditions of renewal set out in the franchise agreement, the franchisor is not at liberty to refuse the renewal. If the franchisor does so anyway, the franchisee can have the right to damages for breach of contract and/or an injunction to force the franchisor to co-operate with the renewal.

Termination

21. Are there any limitations on the right of a franchisor to terminate the agreement?

Regarding termination, the starting point is the wording of the franchise agreement. Where the franchisee has breached the agreement and the wording of the agreement specifically provides for the franchisor's right to terminate, then the franchisor has an enforceable right. However, a court can grant to a defaulting franchisee a right to relief from forfeiture. This right allows the franchisee to:

- Rectify the breach, even where the time for rectification set out in the franchise agreement has past.
- Pay all costs to the franchisor arising out of the breach and enforcement proceedings.
- Reinstate the agreement.

A franchisor, when enforcing a right of termination of a franchise agreement, must abide by the implied covenant of fair dealing under the provincial franchise statutes and at common law. Additionally, the Canadian common law applies to a franchise agreement in the same way as it does to any other agreement. In parallel, the enforcement of termination rights in Québec will be subject to the general obligation of good faith.

A franchisor does not have a right to unilaterally terminate a franchise agreement without cause and, if a franchisor does so, it can be liable for damages to the franchisee. Typically in Canada, the franchise agreement does not contain provisions allowing a franchisee to terminate a franchise agreement before its expiry date. As a result, any right to early termination by a franchisee will only arise where the franchisor significantly breaches the franchise agreement.

Under current Canadian common law, penalty provisions in a franchise agreement are not enforceable, but liquidated damages clauses are, subject to certain restrictions and conditions. Absent a liquidated damages clause, the aggrieved party will be entitled to damages for breach of the franchise agreement under and subject to the various common law rules applicable to damage awards (for example, the obligation to mitigate).

Under Québec civil law, penalty provisions are enforceable provided they are not abusive. While such clauses are often inserted in agreements to dissuade non-compliance, dissuasion is not a justification for excessive penalty amounts. A penalty clause will be deemed abusive if it is excessive given the purpose, scope and context of the obligation it is intended to secure.

22. Are post-term restrictive covenants enforceable?

A restrictive covenant will be void unless it is reasonable. To be reasonable, a restrictive covenant:

- Must protect the franchisor's proprietary interest.
- Must not be broader in geographical area, time period or scope than is necessary to effectively protect the franchisor's interests.

A Canadian court will not re-write or write down or otherwise modify a restrictive covenant in order to make it reasonable and enforceable but rather will either uphold or strike down the covenant in its entirety.

23. Can the franchisor or a replacement franchisee continue to sell to the former franchisee's customers?

Typically, when a franchisee sells its franchise to another franchisee (with the franchisor's consent), the purchase agreement includes a transfer of the previous franchisee's customer/client lists. The transfer of ownership of the customer/client lists for valuable consideration usually permits the incoming franchisee to sell to the customers/clients without paying any compensation to the previous franchisee. The same holds true where the franchisor re-purchases the franchise.

In circumstances where the franchisor enforces its rights under the franchise agreement to take possession of the franchise, the provisions of the franchise agreement usually include not only the right to take possession on certain events or defaults, but also the right to assume control of all the assets of the franchise to the exclusion of the previous franchisee. This will include the right to own and use the customer/client lists in continuing to conduct the franchise business (without compensation to the previous franchisee).

However, as alluded to above, the above is entirely dependent on the terms of the franchise arrangement between the franchisee and the franchisor.

Choice of law and jurisdiction

24. Will local courts recognise a choice of foreign law in a franchise agreement for a business operating in your jurisdiction?

Canadian courts generally recognise the parties' agreement with respect to a choice of foreign law in franchise agreements (for a business operating in a Canadian province or territory), provided there is a sufficient nexus to the parties' relationship. However, Canadian franchise legislation renders void any provision which seeks to restrict the application of the relevant province's law with respect to a claim under such legislation. Furthermore, where the applicable law is that of any province in Canada, the Vienna Convention on the International Sale of Goods will automatically apply unless expressly set aside by the parties in the contract.

25. Will local courts recognise a choice of foreign jurisdiction in a franchise agreement for a business operating in your jurisdiction?

Canadian courts will generally enforce choice of forum clauses in franchise agreements that select foreign courts and jurisdictions to resolve disputes and claims arising from the franchise relationship. However, Canadian franchise legislation renders void any provision

which seeks to restrict the jurisdiction of the relevant province's courts with respect to a claim otherwise enforceable under the relevant legislation.

OPERATIONS MANUAL

26. How does the franchisor ensure that the franchisee complies with the business standards, systems and requirements?

Canadian franchisors try to motivate franchisees to comply with system standards and requirements, which are typically set out in an Operations Manual, in a variety of ways, including persuasion, peer pressure and incentives. Where a franchisee fails to follow the system or meet the system standards, the franchisor can resort to the courts for damages and/or termination of the franchise agreement. However, obtaining an order of the court terminating a franchise agreement for a franchisee's failure to meet system standards or requirements, in the absence of specific defaults and termination rights, depending upon the facts, can be more difficult than in situations where the franchisee's conduct is for breach of contract, such as non-payment of royalties.

27. Can the franchisor change the Operations Manual unilaterally, as is usually required?

Most Canadian franchise agreements give the franchisor the unilateral right to change the Operations Manual and/or system, as the franchisor deems appropriate. Such a right is generally enforceable, unless the changes undercut the basic bargain contained in the franchise agreement, or are being done in bad faith.

LIABILITY ISSUES

28. What are the franchisee's remedies against the franchisor for deceptive or fraudulent selling practices?

Under franchise legislation, a franchisee has a right of action against the franchisor, the franchisor's agent or broker, the franchisor's associate and every person who signed the disclosure document or statement of material change if a franchisee suffers a loss because of a misrepresentation contained in the disclosure document or in a statement of a material change. In addition to these statutory rights of action, a franchisee also has rights of action under common law and the Civil Code in the province of Québec.

29. How can third-party claims against the franchisee be brought successfully against the franchisor?

Indemnity

Depending upon the facts, franchisors and franchisees can possibly bring indemnity claims against the other. However, an important element of a franchise relationship is the legal independence of the parties. Most often franchise agreements are worded to exclude a franchisor from any liability incurred by the franchisee, and to require the franchisee to indemnify the franchisor for any third-party liability arising against the franchisor from the franchisee operating the franchise. However, third parties can nonetheless claim against a franchisor for some types of vicarious liability, if certain factors exist, and the success of such claims will depend upon those factors.

Precautions

As the issue of independence is so critical to a franchisor's exposure to liability to third parties, it is very important for the franchisor to establish in the minds of third parties (customers, clients, suppliers, and so on) that such independence exists. This is done in a number of ways, including:

- Setting out in the franchise agreement that the franchisee will provide appropriate wording in such things as signage, letterhead, invoices and other printed and electronic material that the franchisee is operating the business as an independent entity under licence from the franchisor.
- Ensuring that the franchisee in fact meets such contractual requirements.
- Making known in any marketing and advertising material produced by the franchisor that each franchise is operated independently, under licence from the franchisor.
- Ensuring that all social media postings and websites (whether of the franchisee or the franchisor) bring home obviously and clearly that each franchise is operated independently and under licence from the franchisor.

INTELLECTUAL PROPERTY

30. What provisions are usually made in relation to intellectual property rights (IPRs), including know-how?

Commonly, Canadian franchisors grant to franchisees the right to use the system trade marks and other intellectual property in the operation of the franchised business and for no other purpose. There are usually extensive provisions in the franchise agreement relating to ownership and use of the intellectual property and know-how, both during the term of the franchise agreement and post-termination. Sometimes, franchisors will reserve the right to use the system's intellectual property in a parallel distribution structure (that is, bulk sales through other retail chains) within the franchisee's territory.

31. What are the registration requirements for licensing IPRs?

Other than patents, trade marks are the only type of intellectual property that can be registered to preserve its ownership. This registration is completed under the Canadian Trade-Marks Act, which is a federal statute and applies countrywide. While common law rights to a trade mark would exist merely from the use of the trade mark, the ability to protect a common law trade mark is significantly weaker than a trade mark registered under the statute. Registering the trade mark with the Canadian Office of Intellectual Property has the advantage of providing nationwide protection of the registered trade mark and, in the province of Québec, enables the use of any English-only terminology that is a registered trade mark (provided that no French version of the trade mark has been registered and that a generic description of the goods and services is included in French).

There is no need to register a franchisee as a user of the trade mark. However, if anyone is allowed to use a trade mark without a licence agreement or franchise agreement, the franchisor may lose its ownership rights in the mark under the statute. A Canadian franchise agreement usually includes trade mark licence provisions.

REAL ESTATE

32. Are consents from landlords difficult to obtain when transferring leases or granting subleases from a franchisor to a franchisee?

Every lease situation differs based upon many factors, including:

- The sophistication of the landlord and the tenant.
- The development in which the premises are to be located.
- The size of the leased space.

Most leases require the approval of the landlord for a transfer of the lease or the granting of a sublease, and many leases state that this approval cannot be unreasonably withheld. While there can be situations where the landlord will withhold its approval, it is very common for landlords to grant their approval after being satisfied that the new tenant (or sub-tenant) will operate the business at the leased premises to at least the same standard as the original tenant. It is customary for landlords to charge for granting their consent, to at least cover their costs of the process from start to finish. There is no legal limit on these charges.

33. How can a franchisor prevent the franchisee from occupying the premises after the franchise agreement has ended?

Most franchise agreements are co-terminus with the lease or sublease for the business premises, with cross-termination covenants in each document. Where the franchisor holds the head lease and subleases to the franchisee, it is common for the franchisor to ensure that the term of the head lease is longer than the term of the sublease. That way, the franchisor can maintain control over the premises after the termination of the franchise agreement and sublease.

Where the franchisee is on the head lease, except for any non-compete covenants in the franchise agreement, the franchisee will be free to contract with the landlord after the original franchise agreement and head lease end.

34. How can the franchisor effectively acquire the franchisee's premises at the end of the franchise relationship?

Although not required or prohibited by law, it is common for Canadian franchisors to "own" the premises after termination of the franchise agreement, either through the head lease or a conditional assignment of the lease between the franchisee and the landlord. All leasehold improvements accrue to the landlord under the lease without the need for any payment to the tenant. Usually, franchise agreements provide for some option to the franchisor to purchase moveable assets, at an agreed to price or formula, from the franchisee at the end of the term of the franchise agreement, excluding any value for goodwill.

35. If the franchisor leases or subleases its own site to its franchisee, can it pass on all related costs to the franchisee? Can the franchisor charge its franchisee tenant a rent expressed as a percentage of the franchisee's sales?

Freedom of contract allows the franchisor and the franchisee to strike any deal they wish regarding occupation costs and charges, including percentage rent on the franchisee's sales.

COMPETITION LAW

36. What is the effect of competition law rules on franchising agreements? Are there any available exemptions?

Competition law

The Competition Act sets out certain practices that are reviewable by the Competition Tribunal, upon application by the Commissioner. Matters reviewable include:

- Abuse of a dominant position.
- Mergers.
- Price maintenance.
- Delivered pricing.
- Refusal to deal.
- Refusal to supply by foreign parties.
- Consignment selling.
- Exclusive dealing.
- Tied selling.
- Market restriction.
- Certain misleading advertising and trade practice matters.

The Competition Act also sets out certain criminal offences and allows for the recovery of damages for persons injured by the criminal anti-competitive activities of others. Criminal matters include:

- Conspiracy bid rigging.
- Pyramid and referral selling.
- Telemarketing.
- Certain misleading advertising and trade practice matters.

The Competition Act requires parties to a proposed transaction, before the transaction is completed, to notify the Commissioner that the transaction is proposed and to provide the Commissioner with certain information.

Exemptions

The Competition Act sets out certain exemptions from the requirement to notify the Commissioner of a proposed transaction:

- An acquisition of real property or goods in the ordinary course of such acquisition would not result in the acquirer holding all, or substantially all, of the assets of the business.
- An acquisition of voting shares in a combination solely for the purpose of underwriting the shares.
- An acquisition of voting shares that would result from a gift, intestate or succession or testamentary disposition.
- An acquisition of collateral or receivables resulting from a foreclosure or default or debt work-out made by a creditor.
- An acquisition of a Canadian resource property to carry out exploration or development activities with respect to the property.
- An acquisition of voting shares of a corporation where the acquirer incurs expenses to carry out exploration or development activities with respect to a Canadian resource property.
- A combination that results in no change of control over any party to the combination.

Online/e-commerce restrictions

It is common for Canadian franchisors to require their franchisees to engage in local advertising and marketing. However, it is typical for Canadian franchisors to exercise as much control as possible in advertising and marketing activities to prevent franchisees from deviating from system uniformity. Where a franchisee has its own website, the contents and activities on that website may be subject to franchisor approval.

EMPLOYMENT ISSUES

37. Can a franchisee be regarded as an employee of the franchisor?

Canadian law has typically recognised that franchisees are independent contractors and not employees of their franchisor. However, courts and tribunals have scrutinised the underlying arrangement and agreements between the parties to determine whether the franchisee is truly operating on an independent basis.

Some of the indicia that the courts will look at include:

- Whether the franchisee made its own investment in the business.
- Whether the franchisee has the potential to make profit or the franchisor is paying the franchisee a fixed sum.
- Whether the franchisor or the franchisee owns/finances the inventory and equipment.
- Whether the franchisor or the franchisee is hiring, training and paying the wages of the franchisee's employees.
- Whether there is truly a degree of independence (subject to the necessary brand protection measures) in the franchisee's day-to-day management of operations of the franchise business.
- The general flavour of the relationship between the franchisor and the franchisee.

DISPUTE RESOLUTION

38. How are franchising disputes typically dealt with? What provisions for handling disputes are usually included in domestic franchise agreements?

Some franchise agreements in Canada do not provide for any dispute resolution mechanism and some provide for binding arbitration. Others provide for mediation and/or negotiations as a first condition before proceeding to court. If no dispute resolution mechanism is set out in the franchise agreement, then court proceedings are the only alternative unless the parties agree otherwise after a dispute arises. The common wisdom is that arbitration can be faster and cheaper than court proceedings and, for the franchisor, there is the added advantage that arbitration is a private proceeding and decisions do not become precedents. Other than the mandatory mediation requirements in some provincial jurisdictions applicable to any court proceeding, there is no requirement in law for franchise disputes to be dealt with other than through the courts.

The provincial franchise statutes require that the law and courts of that province apply to any claims under the particular provincial statute. Other than such claims, the franchise agreement can specify the law of any jurisdiction or court outside of Canada for resolving matters between a franchisor and franchisee.

39. How are foreign judgments or foreign arbitral awards enforced locally?

Subject to limited defences, a foreign judgment is typically recognised and enforced in Canada if the foreign court has properly assumed jurisdiction and renders a monetary decision that is final and conclusive on the merits. However, if a claimant seeks non-monetary relief, it is unlikely that a Canadian court will recognise and enforce such non-monetary relief imposed by a foreign court with respect to the conduct of a franchisor or franchisee in Canada.

In addition, Canada is a signatory party of the UN Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (New York Convention). A foreign arbitral award will therefore generally be more enforceable than a foreign judgment. Canada is a signatory to the UNCITRAL Arbitration Rules 1976 and both the federal and provincial governments have also adopted substantially similar legislation. As such, a Canadian court will typically recognise and enforce an arbitral award issued in signatory countries. However, a foreign arbitral award must be enforced by a separate action commenced in a Canadian court. This gives the defendant an opportunity to challenge the jurisdiction and enforceability of that foreign arbitral award.

EXCHANGE CONTROL AND WITHHOLDING

40. Are any exchange control or currency regulations applicable to payments to an overseas franchisor?

There are no exchange control or currency regulations applicable to payments to an overseas franchisor.

41. Is there a withholding obligation on payments made to an overseas franchisor?

Initial franchise fees and royalties paid to a franchisor that is not resident in Canada are generally subject to withholding tax. The withholding tax rate for royalties is 25% subject to any applicable reduction under an applicable tax treaty. Generally, the person making the payment is required to withhold.

REFORM

42. Are there any proposals to reform the laws affecting franchising?

There are ten provinces and two territories in Canada. Five of the provinces (Alberta, Manitoba, Ontario, Prince Edward Island and New Brunswick) have franchise specific legislation in force. British Columbia has passed such a statute, but not settled its regulations as yet. At present there is no other province or territory indicating that it intends to take similar legislative steps. Recently, Ontario amended its regulations to allow for the delivery of franchise disclosure documents and notices of rescission electronically.

The Ontario Bar Association and the Canadian Franchise Association have both made proposals to amend the various franchise statutes, but there is no indication presently of the likelihood of such proposals becoming law.

ONLINE RESOURCES

Canadian Franchise Association

W www.cfa.ca/

Description. The Canadian Franchise Association is the national trade association serving the franchise industry (the code of ethics can be viewed at: www.cfa.ca/about-our-members/cfa-code-of-ethics/).

Canadian Legal Information Institute (CanLII)

W www.canlii.org/en/

Description. The Canadian Legal Information Institute (CanLII) maintains up-to-date legislation and case law. The following links provide information on provincial franchise legislation:

- www.canlii.org/en/on/laws/stat/so-2000-c-3/latest/so-2000-c-3.html. This link is to the Ontario franchise legislation.
- www.canlii.org/en/ab/laws/stat/rsa-2000-c-f-23/latest/rsa-2000-c-f-23.html. This link is to the Alberta franchise legislation.
- www.canlii.org/en/mb/laws/stat/ccsm-c-f156/latest/ccsm-c-f156.html. This link is to the Manitoba franchise legislation.
- www.canlii.org/en/nb/laws/stat/snb-2007-c-f-23.5/latest/snb-2007-c-f-23.5.html. This link is to the New Brunswick franchise legislation.
- www.canlii.org/en/pe/laws/stat/rspei-1988-c-f-14.1/latest/rspei-1988-c-f-14.1.html. This link is to the Prince Edward Island franchise legislation.

Practical Law Contributor profiles



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Professional qualifications. Bar Admissions: Ontario (Canada), 2011; Australia, 2000.

Non-professional qualifications. University of Adelaide, B Soc Sc, 1999; University of Adelaide, LLB (Hons), 1999; University of Adelaide, B Com, Corporate Finance, 2001.

Areas of practice. Franchise and distribution; corporate; mergers and acquisitions; international.

Recent transactions:

- Canadian tourism business master franchisee selling rights back to the global franchisor.
- US restaurant business franchisor entering the Canadian market through sophisticated JV franchising structure.
- Offshore private equity investor acquiring a significant portfolio of restaurant business franchises in Canada.
- Global renovation business franchisor undertaking a system wide rebrand through pilot programme and progressive changeover.
- Healthcare services franchisor establishing its system under license with a leading retail store to roll out healthcare practices across Canada.
- Prominent restaurant business franchisor negotiating and documenting a management buyout arrangement.
- US based emerging beverage company negotiating initial distribution arrangements across the globe and replacement of those arrangements following exponential growth.

Professional associations/memberships:

- Ontario Bar Association (member of the Executive Franchise Law section).
- Canadian Bar Association.
- Law Society of Upper Canada.
- Canadian Franchise Association.
- International Franchise Association (Certified Franchise Executive).
- International Bar Association - International Franchising Committee.
- American Bar Association - Forum on Franchising.
- Invest USA Committee (Board Member, Joint Secretary).

Publications.

Articles:

- Author, "Five Commonly Overlooked Provisions in International Franchise Agreements", Global Franchise, Issue 4, June 2016.
- Author, "How Do I Know If a Franchisor Has a Good Relationship with Its Franchisees?", Franchise Canada, May-June 2016.
- Author, "Adopting a Strategic Intellectual Property Program", The Franchise Voice, Summer 2015, Volume 16 - Issue 3, August 2015.
- Author, "Watch the Extra Step... When Crossing the Resale Exemption Path," Dickinson Wright Franchise & Distribution Newsletter, August 2015.
- Author, "Who Is An 'Officer' For the Purposes of Preparing an FDD Under the Arthur Wishart Act, 2000 and Regulations", April 2015.
- Author, "Navigating the Cyber Liability Storm - Part I", Dickinson Wright Franchise & Distribution Newsletter, January 2015.
- Author, "Navigating the Cyber Liability Storm - Part II", Dickinson Wright Franchise & Distribution Newsletter, January 2015.

Presentations:

- Presenter and Author, "Due Diligence in Franchise System Acquisitions", (Presentation and Paper) Canadian Franchise Association Law Day, January 2016.
- Presenter, "Franchise Disclosure: The Nuts and Bolts", Dickinson Wright Webinar, January 2016.
- Presenter, "Common Challenges in Franchise and Not-For-Profit Practice", The Institute of Legal Clerks of Ontario – Advanced Corporate Program, November 2015.
- Presenter, "Who Is An 'Officer' For the Purposes of Preparing an FDD Under the Arthur Wishart Act?", Ontario Bar Association Franchise Law Dinner Program, March 2015.



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Professional qualifications. Bar Admission: Ontario (Canada), 2015.

Non-professional qualifications:

- University of Windsor, Faculty of Law, Juris Doctor, 2014:
 - Gowlings LLP Prize in Securities Regulation (2012-2013);
 - Insolvency Institute of Canada, E Bruce Leonard Prize in Insolvency & Restructuring (2012-2013);
 - Kellerman Family Bursary in Insolvency & Restructuring (2012-2013).
- Ryerson University, Bachelor of Commerce (Law and Business), 2010 (CB Richard Ellis Year-End Scholarship in Real Estate (2009-2010)).

Areas of practice. Corporate; emerging businesses; franchise and distribution; mergers and acquisitions; securities.

Recent transactions. Representative matters include advising individuals and businesses in connection with:

- Incorporation, organisation and day-to-day corporate governance.
- Ownership agreements (shareholder, partnership and joint venture agreements).
- Purchase and sale agreements (share and asset purchase agreements).
- Commercial agreements (franchise, distribution, licensing and confidentiality agreements).
- Corporate reorganisations and restructurings.
- Succession and estate planning.
- Applications for charitable status registration.
- Foreign investments in Canadian companies.

Professional associations/memberships:

- Canadian Bar Association (member).
- Law Society of Upper Canada (member).
- Ontario Bar Association (member).
- Women Business Enterprises Canada Council (WBE Canada) (Certification Committee member).

Publications:

- Co-Presenter, "Common Challenges in Franchise and Not-For-Profit Practice", The Institute of Legal Clerks of Ontario – Advanced Corporate Program, November 2015.
- Co-Author, Michael Weinczok and Kathy Le, "Canada" in Gregor Baer and Karen O'Flynn, Financing Company Group Restructurings, (UK: Oxford University Press, 2015).
- Co-Author, David Preger and Kathy Le, "Priority Issues under the Construction Lien Act" (paper delivered at the Law Society of Upper Canada, Commercial Priorities for Real Estate and Business Lawyers 2015, 24 February 2015).

Professional qualifications:

- York University, BA, 1970.
- Osgoode Hall Law School, JD, 1973.
- Called to the Bar of Ontario, 1975.
- Certified Franchise Executive, 2010.

Areas of practice. Franchising and distribution.

Recent transactions. Ned is one of Canada's leading authorities in franchising and distribution law. He has represented some of the world's foremost franchises, and provides legal services to Canadian and International clients on all aspects of Canadian franchise law. Additionally, from 2000-2007, he was General Counsel to the Canadian Franchise Association and is currently a member of the International Committee of the International Franchise Association.

Professional associations/memberships:

- American Bar Association.
- Forum on Franchising.
- Canadian Franchise Association.
- International Bar Association.
- International Franchise Association.

Publications:

- "Setting Fees in International Franchise Agreements", presented at International Franchise Association Annual Convention, 21 February 2016.
- "Due Diligence in Franchise System Acquisitions", presented at 2016 CFA Franchise Law Day, 28 January 2016.
- "Drafting and Negotiating an International Franchise Agreement", Franchising World, June 2015.
- "Talk to a Franchise Lawyer Before Going Global", The Lawyers Weekly, 17 July 2015
- "Duty of Good Faith and Fair Dealing", The Franchise Valuations Reporter, June 2015 ("Good Faith in Franchising", Lexpert Conference on Implied Obligation of Good Faith, 2 June 2015).

