



# 5 Must-Dos for Franchising in Canada

Canada is becoming increasingly attractive for brands looking for an English (and French) speaking market. Franchise attorney Andrae Marrocco prepares you for an adventure to the Great White North

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**C**anada, much heralded as a frozen hockey rink, has turned out to be a hot market for franchisors.

Canada has a highly skilled and educated workforce and a similar spending pattern to the United States. It has the second largest franchise industry in the world, behind the US, with an estimated 1,300 franchise brands and more than 78,000 franchised business units. It is also a proudly multicultural country, making it a good 'first expansion' venue to test your franchise system among a variety of cultural demographics.

However, franchise expansion to the Great White North requires guidance and careful decision-making. Here are five things to consider before expanding your franchise system into Canada.

## 1 Protect your intellectual property

A franchise system's intellectual property is often the most important asset crossing the border on any international expansion, and the same holds true when venturing into Canada. This includes trademarks, know-how, trade secrets, copyright, and patents, as well as non-traditional types of intellectual property like domain names – both existing and contemplated (eg “.ca” domain extensions). Franchisors should take the time to identify the intellectual property that is actually necessary for their international expansion into Canada and robustly protect each category of intellectual property under Canadian law.

Canada's trademark registration system recently underwent a

significant transformation as part of an initiative to modernize the national intellectual property framework. In addition to substantial amendments to the *Trademarks Act* (Canada), the regulations, and Trademark Office practices, Canada is joining three international trademark treaties. Not only is Canada finally acceding to the Madrid Protocol, the international system for obtaining trademark registrations for multiple jurisdictions through the use of a single application, but Canada is also joining the Nice Agreement, which establishes an international classification system for goods and services in trademark registrations, as well as the Singapore Treaty, which seeks to harmonize administrative procedures pertaining to the trademark registration process.

## **“Though Canada is the second largest country in the world, the vast majority of its population lives within 300km of its southern border”**

### **2 Structure your franchise expansion**

Determining the right structure for your franchise expansion into Canada is a critical part of early planning and, unfortunately, too frequently overlooked (particularly at the strategy stage). Franchisors need to address the following two structuring considerations.

The first is selecting one or more strategically advantageous franchise structures for the expansion (eg, master franchise, area development, direct franchising, etc) and the particular regions for which those structures will be utilized. More often than not, this involves blending structures and crafting customized terms that fit the specific franchise system and expansion mandate. It also requires conducting research on the demand for your products or services in various regions while also considering other economic, demographic and cultural variables. By way of example, you may determine that direct franchising is the structure of choice for major regions like Toronto and/or Ontario, but a master arrangement is more suitable for the province of Quebec (which has a civil law system and French language requirements).

The second structuring consideration is selecting the most efficient Canadian corporate/tax structure to achieve your business objectives. Franchisors need tailored advice to ensure that they identify a structure that satisfies the “line of best fit” test. The analysis is typically based on a number of considerations including capitalization strategies, contemplated on the ground operations (eg employees and physical premises), the intention vis-à-vis repatriation of funds, the interplay between home jurisdiction

tax laws and Canadian tax laws, and Canadian laws that may be applicable because of your specific industry.

### **3 Craft your franchise agreement**

Well-crafted franchise agreements underpin effective expansion into Canada. Particularly where you have an existing suite of franchise agreements and where you intend to utilize a number of franchise structures, the preparation of a uniform and “Canadianized” set of franchise agreements is high on the priority list. Canadian courts have provided guidance on many aspects of the franchise arrangement. The form and substance of drafting Canadian agreements has been impacted in a profound manner by the principles espoused by court decisions together with Canadian legal custom which has developed from those principles (and independent of them). Observing those principles and legal customs will go a long way to protecting your franchise system in Canada.

Certain key mechanisms in your franchise agreements such as “protected” or “exclusive” territory should be carefully reviewed for Canada. The manner in which you ultimately define and divide territories in Canada may be

significantly different than other countries in which your franchise systems operate. Though Canada is the second largest country in the world, the vast majority of its population lives within 300km of its southern border. Carving up the 10 provinces and three territories into workable franchise regions requires strategy and consideration. Importantly, franchisors are cautioned not to give away too much territory without protective rights (eg in circumstances of breach or underperformance).

International franchisors should also observe current trends to ensure their brand holds strong appeal among prospective franchisees. In Canada, there has been an increased trend of franchise systems providing franchisees with limited flexibility on various activities that were historically more stringently controlled. For example, an increasing number of Canadian franchisors are giving franchisees latitude to source local products and services. This benefits international franchisors in a number of ways including saving them time and effort on establishing supply chains, as well as creating supply chain options for other franchisees. From the franchisee’s perspective, it engenders goodwill in the community in which its franchised business operates.

These are but a few illustrations of the importance of “Canadianizing” your franchise agreements (and the underlying business terms) so that your franchise system is relevant for the Canadian business community and complies with Canadian legal principles and customs.



## 4 Comply with Canadian laws

Six of Canada's provinces (Alberta, British Columbia, Manitoba, New Brunswick, Ontario, and Prince Edward Island) have franchise-specific legislation. While not identical, the provincial statutes are substantially similar. One of the primary requirements mandated by each statute is that franchisors provide pre-sale disclosure with respect to the franchise offering in the form of a franchise disclosure document. The franchise disclosure document is intended to provide prospective franchisees with sufficient information to make an informed business decision about becoming a franchisee. Consequences for non-compliance with the franchise statutes (whether as a result of omitting prescribed information, failing to follow the execution and delivery obligations, or otherwise) can result in serious pecuniary consequences for international franchisors.

Unsurprisingly, there are other Canadian laws that international franchisors should be mindful of in expanding their franchise system to Canada. Firstly, it is worth noting that even provinces without specific franchise legislation have laws that significantly impact the expansion and operation of franchised businesses, such as Quebec's *Civil Code* and *Charter of the French Language* (which includes requirements of 'doing business' in the French language). Depending on your intentions with respect to scouting out and operating in Canada, immigration laws will impact any personnel you plan on having visit/move to Canada. You may also need to consider trade and custom laws for product and equipment importation, taxes (including withholdings tax), employment laws (which differ between the provinces), and industry specific laws.

Moreover, Canada has a complex framework with respect to privacy and data protection. Maintaining robust data protection and privacy protocols is critical to the development and reputation of international franchise systems entering Canada. At a high level,

Canadian laws require the following implicit and explicit accountability and security obligations:

- businesses are responsible for personal information in their possession or under their control and must designate an individual or individuals who are accountable for compliance; and
- security safeguards must protect personal information against loss or theft, as well as unauthorized access, disclosure, copying, use, or modification, regardless of the format in which it is held (the nature of the safeguards will vary depending on the sensitivity of the information that has been collected, the amount, distribution, and format of the information, and the method of storage).

In a landscape of ever-increasing privacy law regulation and scrutiny in Canada, it is imperative that international franchisors develop and implement adequate policies and programs from the outset to ensure that their franchise operations in Canada safeguard personal information in compliance with applicable legal and regulatory requirements.

## 5 Know when to be hands on versus hands off

As in many parts of the world, franchisors operating in Canada are experiencing the expanding boundaries of vicarious liability. That includes the much publicized "joint employer" risks ("common employer" in Canada). Accordingly, franchisors must strike the right balance of protecting their brand and assisting their franchisees without crossing the line of being so involved that they assume liability. For the purposes of common employment, the fundamental question is where does "effective control" over employees reside: the franchisor, the franchisee or both? The more control exerted by the franchisor, the more likely that the franchisor will be found to be a common employer. In addition to the degree of control exercised, other factors suggesting a common employer relationship include:

- the integration between the franchisor and franchisee, including common shareholders or directors;
- the payment of wages to the employee by the franchisor and/or franchisee;
- existence of an employment contract between the employee and the franchisor and/or franchisee; and
- the employee's relationship with and service to the franchisor and/or franchisee.

On the other side of the spectrum, a disinterested or neglectful franchisor may wind up being liable on that count. One example comes from the *Dunkin' Donuts* case heard by the Quebec Court of Appeal (2015 QCCA 624). The worldwide donut chain Dunkin' Donuts faced a serious intrusion into its stronghold over the Quebec market by rival brand Tim Hortons. The Court held that Dunkin' Donuts failed to protect and improve the brand's image and value amidst this competition, resulting in damages of approximately 11 million dollars. Among other things, the Court held that Dunkin' Donuts failed to appropriately address poorly performing franchisees who were harming the brand image.

Prudent international franchisors looking to expand their franchise systems into Canada should take time to plan, protect their brand, consider the optimum structure, prepare best in class documentation and, in all things, ensure they comply with all applicable Canadian laws. This will put them on a strong footing for effective and efficient expansion.



### THE AUTHOR

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