

# Something Old, Something New: A Comparison of Canada's Newest Franchise Legislation Against Existing Franchise Laws

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Prince Edward Island and New Brunswick have become the latest provinces in Canada to introduce franchise-specific legislation. While the new legislation in both provinces is substantially similar to the country's other franchise-specific legislation (Ontario's Arthur Wishart Act (Franchise Disclosure), 2000 and Alberta's Franchises Act), legislation with which most franchisors in Canada are already familiar, there are some noteworthy exceptions.

## I. INTRODUCTION

Alberta was Canada's first province to introduce franchise-specific legislation with the enactment of its *Franchises Act* in 1972, which was later overhauled in 1995<sup>1</sup> (the "Alberta Act"). Despite substantial public interest in franchising practices that arose from several high profile lawsuits during the 1980s, it became clear that any other province would not soon follow Alberta's initiative. Indeed, over twenty-five years passed before Ontario joined Alberta by introducing the *Arthur Wishart Act (Franchise Disclosure)*, (the "Ontario Act") in 2000.<sup>2</sup>

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<sup>1</sup> *Franchises Act*, R.S.A. 2000, c. F-23.

<sup>2</sup> Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c.3.

Had this breakneck pace continued, Canadians would have been celebrating seeing franchise legislation enacted across Canada sometime in the fall of the year 2210. However, public interest in franchise legislation remained high, and the Uniform Law Conference of Canada ("ULCC") was charged with drafting template franchise legislation and associated regulations as a proposed model for franchise legislation in all provinces and territories other than Ontario and Alberta. The ULCC approved an interim draft of the legislation in principle at its annual meeting in August 2004, which was largely reflected in Prince Edward Island's Bill 43 – legislation that received first reading in the province's legislative assembly on 12 May 2005. The province became Canada's third province to enact franchise-specific legislation when the bill—now known as the *Franchises Act*<sup>3</sup>—received Royal Assent on 7 June 2005 (the "PEI Act"). Certain provisions of the PEI Act came into force on 1 July 2006, while the obligation to distribute a disclosure document came into effect six months later, on 1 January 2007.

By the time the PEI Act received royal assent, the ULCC had adopted its final version of the *Franchises Act* (the "ULCC Act") at its annual meeting in August 2005.<sup>4</sup> On 7 December 2005, exactly six months after Prince Edward Island's enactment of the PEI Act, New Brunswick's Bill 6—the *Franchises Act*<sup>5</sup>—received first reading. The bill died on the Order paper when the legislature dissolved for a provincial election. The bill was then reintroduced as Bill 32 (the *Franchises Act*) on 23 February 2007 when it received first reading in New Brunswick's fifty-sixth legislative assembly. The *Franchises Act*<sup>6</sup> (the "New Brunswick Act") received Royal Assent on 26 June 2007 and is expected to be proclaimed into force upon the promulgation of disclosure regulations.

This actually may be the beginning of a cross-country initiative that will see franchise legislation enacted in most, if not all, provinces. Of course, if this is the case, franchisors will hope to see legislation that is substantially the same across the country to avoid having to deal with different statutory regimes in each province.

The New Brunswick Act, the PEI Act, and the ULCC Act are all substantially similar to the format and content of the Ontario Act. However, there are a few significant changes that will have definite impact on how franchisors conduct business in those provinces. This paper compares the ULCC

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<sup>3</sup> *Franchises Act*, S.P.E.I. 2005, c. 36.

<sup>4</sup> The act and associated regulations are available online at: <http://www.ulcc.ca/en/us/>

<sup>5</sup> Bill 6, *Franchises Act*, 3d Sess., 55th Leg., New Brunswick, 2006.

<sup>6</sup> *Franchises Act*, S.N.B. 2007, c. F-23.5 (not in force).

Act, the PEI Act and the New Brunswick Act against the Ontario Act. The Alberta Act contains largely similar concepts to the Ontario Act, but the format of the Alberta Act is significantly different. Accordingly, this paper compares the Alberta Act to the Ontario Act only where differences arise between the Ontario Act and the other legislation. In addition, an analysis of the differences in disclosure requirements in the regulations made under each act is beyond the scope of this paper.

### A. Definitions

The definition sections in each of the New Brunswick Act and the PEI Act (collectively, the "Atlantic Legislation") and the ULCC Act are substantially similar to the definition section found in the Ontario Act. Of the differences, many are minor. For example, the definitions of a "franchise" in the Atlantic Legislation and the ULCC Act omit reference to the licensing of a "service mark", but this term appears in the Ontario Act and the Alberta Act. However, as there is no concept of a service mark in Canada's federal *Trade-marks Act*, this difference is unlikely to result in any practical difference with respect to how the definition is applied to a particular business relationship in each respective jurisdiction.

Other changes are significant. Specifically, consider the changes to the following excerpted definitions of a "material change" and a "material fact":

**Table 1**  
**Material Change**

Ontario Act	Means a change in the business, operations, capital or control of the franchisor or franchisor's associate, a change in the franchise system <i>or a prescribed change</i> , that would... [emphasis added.]
ULCC Act	Means a change, in the business, operations, capital or control of the franchisor or franchisor's associate <i>or in the franchise</i> or the franchise system that would.... [emphasis added.]
PEI Act	Means a change, in the business, operations, capital or control of the franchisor or franchisor's associate <i>or in the franchise</i> or the franchise system that would.... [emphasis added.]

New Brunswick Act	Means a change, in the business, operations, capital or control of the franchisor or franchisor's associate <i>or in the franchise</i> or the franchise system that would.... [emphasis added.]
Alberta Act	Means (i) a change in the business, operations, capital or control of the franchisor or its associate, or (ii) a change in the franchise system, that would...

Note the addition of the term "or in the franchise" in the ULCC Act and the Atlantic legislation. This term is not included in the definition of a "material change" in either the Ontario Act or the Alberta Act.

It is anticipated that the impact of this change will be significant. Note that the definition of a "franchise" begins with "a right to engage in a business... ." A narrow interpretation of the addition of the term "or in the franchise" to the definition of a material change would suggest that a franchisor must disclose any material change to the right to engage in a business. However, a more conservative and prudent interpretation of the addition would obligate a franchisor to disclose a material change to any element of what constitutes a "franchise". This interpretation casts the net extremely broadly, and a franchisor would have to consider all of the elements that are included in the definition of a franchise, such as a change to the business itself, the nature of the payment or continuing payments, the right to sell, offer for sale or distribute goods or services, etc. The breadth of what constitutes a "material change", combined with the number of factors which comprises a "franchise", means that the inclusion of "or in the franchise" to the definition of a material change significantly expands the scope of what must be disclosed between the time that the original disclosure document is delivered to the franchisee and the signing of any franchise agreement or payment of any consideration.

Note that the Ontario Act is the only legislation that includes the possibility that the definition could be expanded by a prescribed change in the regulation. This currently results in no practical difference as no changes are prescribed in the Ontario Act. However, it may result in a divergence between the Ontario Act and other legislation if any such changes are prescribed in Ontario in the future.

**Table 2**  
**Material Fact**

Ontario Act	Includes any information about the business, operations, capital or control of the franchisor or franchisor's associate, or about the franchise system, that would...
ULCC Act	Means any information, about the business, operations, capital or control of the franchisor or franchisor's associate <i>or about the franchise</i> or the franchise system, that would.... [emphasis added.]
PEI Act	Means any information, about the business, operations, capital or control of the franchisor or franchisor's associate <i>or about the franchise</i> or the franchise system, that would.... [emphasis added.]
New Brunswick Act	Means any information, about the business, operations, capital or control of the franchisor or franchisor's associate <i>or about the franchise</i> or the franchise system, that would.... [emphasis added.]
Alberta Act	Means any information about the business, operations, capital or control of the franchisor or its associate, or about the franchise system, that would...

Note that the Ontario Act is the only legislation that starts the definition of a "material fact" with: "material fact *includes...* ." The ULCC Act, Alberta Act and the Atlantic Legislation limit a material fact to *only* those items covered by the definition. This means that while a franchisor in Ontario may over-disclose for fear of falling short of covering all possible material facts, franchisors in other provinces have some comfort that there is no possibility that a franchisee can argue that some information that was not specifically included within the four corners of the definition is still a material fact that should have been disclosed.

In addition, the definition of "material fact" in the ULCC Act and the Atlantic Legislation includes information "about the franchise". As noted above

with respect to the definition of a material change, this addition significantly expands the scope of what could be included in the definition.

## B. Application of the Legislation

### 1. *The Crown*

Whether the Crown is bound by franchise legislation varies by province, as noted below:

**Table 3**  
**Application to the Crown**

Ontario Act	The Ontario Act does not apply to a service contract or franchise-like arrangement with the Crown or an agent of the Crown.
ULCC Act	The Act binds the Crown (but the Crown is not required to provide financial statements in a disclosure document).
PEI Act	The Act does not bind the Crown.
New Brunswick Act	The Act binds the Crown (but the Crown is not required to provide financial statements in a disclosure document).
Alberta Act	No exemption for the Crown.

In provinces in which the Crown is bound, this will mean that provincial agencies, for example which outsource their operations on a franchised basis (e.g., liquor stores, lotteries, motor vehicle license outlets) will be subject to franchise legislation.

### 2. *Retroactive Application*

Each of the Ontario Act, the Alberta Act, the Atlantic Legislation, and the ULCC Act includes a provision stating that certain sections of the legislation will apply to all franchise agreements, and businesses operated under such agreements, even if the parties entered into the agreements prior to the legislation coming into force. This retroactive application of certain sections of the legislation has the very real possibility of catching unwary franchisors off guard, who may be unaware of the additional obligations imposed on them.

The chart below is a summary of the provisions in each piece of legislation that have retroactive effect.

**Table 4**  
**Retroactive Provisions**

	Ontario	New Brunswick	PEI	ULCC	Alberta
Duty of Fair Dealing	✓ Section 3	✓ Section 3	✓ Section 3	✓ Section 3	✓ Section 7
Right to associate	✓ Section 4	✓ Section 4	✓ Section 4	✓ Section 4	✓ Section 8
Right of action for contravening right to associate					✓ Section 11
Disclosure exemption re: renewal or extension of a franchise					✓ Section 5(1)(d)
Disclosure exemption re: grant by an executor	✓ Section 5(7)(d)	✓ Section 5(8)(d)	✓ Section 5(7)(d)	✓ Section 5(8)(d)	✓ Section 5(1)(f)
Exemption by the Minister					✓ Section 6
Exemption by the Minister for financial statements			✓ Section 8		
Dispute Resolution		✓ Section 8		✓ Section 8	

No derogation of other rights	✓ Section 9	✓ Section 10	✓ Section 10	✓ Section 10	✓ Section 15
Governing Law		✓ Section 11	✓ Section 11	✓ Section 11	
No Waiver	✓ Section 11	✓ Section 12	✓ Section 12	✓ Section 12	
Burden of Proof	✓ Section 12	✓ Section 13	✓ Section 13	✓ Section 13	
Regulation making authority					✓ Section 20
Self government					✓ Section 21

**i. Ontario**

The following provisions in the Ontario Act have retroactive application:

- (i) Section 3 – Duty of fair dealing: Each franchise agreement imposes on each party the duty of fair dealing.
- (ii) Section 4 – Right to associate: A franchisee may associate with other franchisees, and may form an organization of franchisees, and the franchisor may not interfere with such association.
- (iii) Section 5(7)(d) – Disclosure exemption for administrators: An executor, administrator, trustee or similar person is not required to provide a disclosure document in connection with a grant of a franchise by that person.
- (iv) Section 9 – No derogation of rights: All rights granted by the Ontario Act are in addition to, and do not derogate from, any other right or remedy available to the franchisee or the franchisor.
- (v) Section 11 – No waiver: Any purported waiver by the franchisee of any of its rights under the act is void.
- (vi) Section 12 – Burden of proof: The burden of proving an exemption or an exclusion from a requirement or provision is on the person claiming it.

## **ii. New Brunswick/ULCC**

Most of the sections are the same as those listed in the equivalent section of the Ontario Act. Two significant differences are:

- (i) Section 8 – Dispute Resolution: Any party to a franchise agreement may require the other party to engage in the dispute resolution procedure set out in the legislation. The procedure will be imposed on franchisors with existing franchise agreements even if such franchisors had made a conscious decision to exclude any such procedure from their franchise agreements.
- (ii) Section 11 – Governing Law and Venue: Any provision in a franchise agreement purporting to restrict the application of the law of New Brunswick, or the venue to a location outside New Brunswick, is void with respect to a claim enforceable under the act. In essence, this means that the law of the province of New Brunswick will apply to most claims made under any franchise agreement in the province, regardless of when such agreements were entered into. This effectively re-writes the governing law section of franchise agreements already in existence. The only exception is that this section will not apply to a claim if an action based on the claim was commenced before the legislation came into effect.

## **iii. Prince Edward Island**

The retroactive sections of the PEI Act are also substantially similar to those in the Ontario Act. The differences from the Ontario Act are:

- (i) Section 8 – Minister's Exemption: The minister may order exemptions for a particular franchisor from providing financial statements in a disclosure document. The significance of the retroactive application of Section 8 to agreements entered into prior to the coming into force of the PEI Act is not clear, and is possibly an error in the legislation. As Section 5(1) (the obligation to disclose) does not apply to such agreements, it is not clear when Section 8 would even be applicable.
- (ii) Section 11 – Governing Law and Venue: The significance of the retroactive application of Section 11 is the same as is noted above with respect to the same provision in the New Brunswick Act. However, the PEI Act does not include a similar exception for existing claims as is included in the New Brunswick Act. This means a franchisee could attempt to take the position that the law of Prince Edward Island applies to pending actions with the franchisor. This may force the franchisor to abandon existing proceedings in jurisdictions outside Prince Edward Island, and resume or restart

such proceedings in Prince Edward Island.

#### **iv. Alberta**

Of all the franchise-specific legislation, the Alberta Act has the most sections which apply retroactively to franchise agreements entered into prior to the act coming into effect. However, as the Alberta Act has been in effect for approximately twelve years, Section 3(2), which provides for retroactive application of other provisions of the act, is likely used with decreasing frequency with the increasing the proportion of franchise agreements entered into after the legislation coming into effect (in which case all the provisions of the act will apply without the need for Section 3(2)).

### ***3. Continuing Commercial Relationships***

#### **i. Ontario**

Section 2(3) of the Ontario Act exempts the following continuing commercial relationships from the application of the legislation:

1. Employer-employee relationship.
2. Partnership.
3. Membership in a co-operative association, as prescribed.
4. An arrangement arising from an agreement to use a trade-mark, service mark, trade name, logo or advertising or other commercial symbol designating a person who offers on a general basis, for consideration, a service for the evaluation, testing or certification of goods, commodities or services.
5. An arrangement arising from an agreement between a licensor and a single licensee to license a specific trade-mark, service mark, trade name, logo or advertising or other commercial symbol where such licence is the only one of its general nature and type to be granted by the licensor with respect to that trademark, service mark, trade name, logo or advertising or other commercial symbol.
6. An arrangement arising out of a lease, licence or similar agreement whereby the franchisee leases space in the premises of another retailer and is not required or advised to buy the goods or services it sells from the retailer or an affiliate of the retailer.
7. A relationship or arrangement arising out of an oral agreement where there is no writing which evidences any material term or aspect of the relationship or arrangement.
8. A service contract or franchise-like arrangement with the Crown or an agent of the Crown.

## ii. New Brunswick/Prince Edward Island/ULCC

Section 2(4) of the New Brunswick Act, Section 2(3) of the PEI Act, and Section 2(3) of the ULCC Act also exclude certain ongoing commercial relationships from the application of the respective legislation. The exemptions are substantially similar to the corresponding section in the Ontario Act, but for the following changes:

*Exemption for a Lease Arrangement:* The New Brunswick Act, the PEI Act and the ULCC Act omit the exemption in Section 2(3)(6) above relating to "an arrangement arising out of a lease, licence or similar agreement whereby the franchisee leases space in the premises of another retailer and is not required or advised to buy the goods or services it sells from the retailer or an affiliate of the retailer."

However, this omission may have little practical impact on whether a business relationship was considered a franchise. If the franchisee were simply leasing space from a lessor, then such a relationship would not normally come within the definition of a "franchise" in any event. If there are other elements to the relationship (i.e. the grant of representational or distribution rights), then the relationship could be subject to the act in either province.

*Addition of the Wholesale Purchaser Exemption:* Section 2(4)(g) of the New Brunswick Act, Section 2(3)(g) of the PEI Act, and Section 2(3)(g) of the ULCC Act exempts from the application of the act "an arrangement arising out of an agreement (i) for the purchase and sale of a reasonable amount of goods at a reasonable wholesale price, or (ii) for the purchase of a reasonable amount of services at a reasonable price."

This exemption will likely come as some relief to businesses operating a straight distribution system. As this exemption has no equivalent in the Ontario Act, it has been an open issue whether payments made for goods, even at wholesale prices, would be considered to be "a payment or continuing payments" that would be captured by the first part of the definition of a "franchise".

Under a plain language interpretation of the term, product purchases by a franchisee/distributor would appear to be "a payment" to a manufacturer. This means that the Ontario Act will likely capture many distribution systems not normally considered to be a franchise. Some commentators have taken the position that this result is clear and unavoidable, and we note that the white paper published by the Ontario government prior to the introduction of the legislation noted that the government's intention was that certain distribution systems be captured by the legislation.

Most states in the United States have franchise legislation that requires the payment of a "franchise fee" for a business to be considered a franchise. It is noteworthy that almost all of these states specifically exempt from the definition of a "franchise fee" any payment made for inventory in reasonable quantities at *bona fide* wholesale prices. The Ontario Act does not include any such exemption, and instead of referring to a "franchise fee," refers to the lower

threshold of "a payment made in the course of operating the business." Indeed, the Alberta Act specifically excludes *bona fide* payment for inventory from the definition of a "franchise fee."

However, the exemption must be read in context of the definition of a "franchise", as to see it as a separate test would create two competing standards of the applicability of the legislation. Of course, a strict manufacturer/distributor relationship (without any other elements of a franchise) would not satisfy the definition of a franchise due to the lack of operational control over the purchaser by the vendor.

*Binding the Crown:* The New Brunswick Act and the ULCC Act omit the exemption regarding the non-application of the legislation to the Crown.

*Cooperative Associations:* The definitions of co-operative associations that are set out in the Atlantic Legislation are essentially identical to the definition set out in the Ontario regulation.<sup>7</sup> This will likely not result in any difference in how the term is applied in the respective jurisdictions.<sup>8</sup>

### iii. Alberta

There is no equivalent section in the Alberta Act to Section 2(3) of the Ontario Act. However, as noted above, the purchase of a reasonable amount of goods at wholesale prices is specifically excluded from the definition of a "franchise fee".

### 4. Franchisor's Broker

The Atlantic Legislation and the ULCC Act includes a definition of a "franchisor's broker" that is similar to the definition in Section 7(1)(c) of the Ontario Act, but omits any use or definition of a "franchisor's agent". The definition of a franchisor's agent in the regulation made under the Ontario Act is "a sales agent of the franchisor who is engaged by the franchisor's broker and who is directly involved in the granting of a franchise." As a practical matter, it is unlikely that the omission of a definition of a "franchisor's agent" will result in any difference in the way the legislation is applied in each respective province: A person who would be captured by the definition of a "franchisor's agent" in the Ontario Act would also likely be considered to be a "franchisor's broker" under the Atlantic Legislation.

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<sup>7</sup> O. Reg. 581/00.

<sup>8</sup> As each of the New Brunswick Act and the PEI Act refer to the respective provincial co-operative associations acts in each province, the uniformity of the application of co-operative association exemption will depend on the differences in the definition of a "co-operative association" in each act.

### ***5. Fair Dealing***

The Ontario Act and the Alberta Act both deem that each franchise agreement imposes on each party a duty of fair dealing in the performance and enforcement of the agreement. Since the legislation was enacted, there has been an open and hotly debated issue of whether a party exercising a right is required to do so in accordance with the duty of fair dealing. Arguably, depending on the circumstances, the exercise of a right is not an enforcement action, nor is it something that the party is required to do (i.e. an obligation of performance), and accordingly is not subject to fair dealing.

The New Brunswick Act, PEI Act and ULCC Act all address this issue by stating that the performance and enforcement of an agreement includes the exercise of a right under the agreement. Accordingly, franchisors must consider their obligations under the duty of good faith even if exercising a right or an option granted by the franchise agreement.

This addition, combined with the retroactive application of the duty of fair dealing in all legislation and the right of action for a breach of the duty, could give rise to problems for some franchisors. A franchisor that has, in the past, been relying on the position that an exercise of a right is not subject to the duty of fair dealing may be faced with any number of actions from its franchisees.

### ***6. Exemptions from Disclosure***

The Ontario Act sets out the following exemptions from the requirement to provide a disclosure document to a prospective franchisee:

Section 5:

(7) This section does not apply to,

(a) the grant of a franchise by a franchisee if,

(i) the franchisee is not the franchisor, an associate of the franchisor or a director, officer or employee of the franchisor or of the franchisor's associate,

(ii) the grant of the franchise is for the franchisee's own account,

(iii) in the case of a master franchise, the entire franchise is granted, and

(iv) the grant of the franchise is not effected by or through the

franchisor;

(b) the grant of a franchise to a person who has been an officer or director of the franchisor or of the franchisor's associate for at least six months, for that person's own account;

(c) the grant of an additional franchise to an existing franchisee if that additional franchise is substantially the same as the existing franchise that the franchisee is operating and if there has been no material change since the existing franchise agreement or latest renewal or extension of the existing franchise agreement was entered into;

(d) the grant 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;

(e) the grant of a franchise to a person to sell goods or services within a business in which that person has an interest if the sales arising from those goods or services, as

anticipated by the parties or that should be anticipated by the parties at the time the franchise agreement is entered into do not exceed 20 % of the total sales of the business;

(f) the renewal or extension of a franchise agreement where there has been no interruption in the operation of the business operated by the franchisee under the franchise agreement and there has been no material change since the franchise agreement or latest renewal or extension of the franchise agreement was entered into;

(g) the grant of a franchise if,

(i) the prospective franchisee is required to make a total annual investment to acquire and operate the franchise in an amount that does not exceed \$5,000,

(ii) the franchise agreement is not valid for longer than one year and does not involve the payment of a non-refundable franchise fee, or

(iii) the franchisor is governed by section 55 of the Competition Act (Canada);

(h) the grant of a franchise where the prospective franchisee is investing over \$5,000,000 in one year in the acquisition and operation of the franchise.

The Atlantic Legislation and the ULCC Act sets out certain exemptions from the requirement to provide a disclosure document to a prospective franchisee which are mostly similar to those set out in the Ontario Act. However, there are a few significant changes:

#### **i. A "Fractional Franchise"**

The Atlantic Legislation and the ULCC exempt a franchisor from providing a disclosure document to a franchisee incorporating the franchise business in an existing business if the sales arising from the franchise business will not exceed twenty percent of the total business *in the first year of operation*. The corresponding exemption in the Ontario Act and Alberta Act (known as the fractional franchise exemption) omits any mention of the time period in which the calculation must be made. The clarification in the Atlantic Legislation and the ULCC provides the franchisor with some certainty that a franchisee who, subsequent to the first year of operation, was more successful with the franchise business than either party anticipated at the time of entering into the franchise agreement, will not retroactively claim that disclosure should have been made.

#### **ii. Short-Term Franchisee**

The Ontario Act provides an exemption for a short-term franchise (i.e. if the franchise agreement is not valid for longer than a year) provided there is no payment of a non-refundable franchise fee. The Atlantic Legislation significantly changes this exemption by adding the further proviso that the exemption is only applicable if "the franchisor or franchisor's associate provides location assistance to the franchisee, including securing retail outlets or accounts for the goods or services to be sold, offered for sale or distributed or securing locations or sites for vending machines, display racks or other product sales displays used by the

franchisee." Clearly, this is meant to echo part (b)(ii) of the definition of a "franchise", and significantly limits the application of the exemption to those franchises which come within that part of the definition *and* are for terms less than one year and do not provide for payment of a non-refundable franchise fee. The Alberta Act does not contain an equivalent section.

### **iii. Renewing Franchisees**

The Alberta Act provides an exemption from disclosure for "the renewal or extension of an existing franchise agreement." The Ontario Act, ULCC Act and Atlantic Legislation all add the additional requirements that there be (i) no interruption of the operation of the franchised business and (ii) no material change since the last franchise agreement was signed.

### **iv. Sophisticated Franchisee**

Lastly, the Ontario Act provides that a franchisor does not have to provide disclosure to a franchisee who will invest \$5 000 000 in the franchise in a one-year period (known as the "sophisticated franchisee exemption"). This exemption is not included in the Atlantic Legislation, the ULCC Act or the Alberta Act, meaning that even well-funded, sophisticated franchisees must receive disclosure in those jurisdictions. However, the exemption under the Ontario Act has proven to be problematic as it is uncertain how the term "invest" is to be interpreted.

## ***7. Use of a Wraparound or Addendum***

A question commonly asked by franchisors that are considering expanding their franchise systems into Canada is whether the obligation to provide a disclosure document can be satisfied by the provision of a UFOC (or a similar disclosure document in another jurisdiction) with a province-specific addendum, or wraparound.

### **i. Alberta**

Section 2(2) of the regulation<sup>9</sup> made under the Alberta Act specifies that a franchisor may use a document authorized under the franchise law of a jurisdiction outside Alberta as its disclosure document provided that the franchisor prepares a supplemental addendum with the additional information required by the Alberta regulation.

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<sup>9</sup> Alta. Reg. 240/1995.

**ii. PEI**

Section 3(2) of the regulation<sup>10</sup> made under the PEI Act also expressly authorizes a franchisor to use a document prepared under the franchise law of another jurisdiction as its disclosure document if the franchisor provides supplemental information as necessary to comply with the PEI disclosure requirements.

**iii. Ontario**

Ontario has no equivalent section to the foregoing. Given that the Ontario Act was introduced subsequent to the Alberta Act and the legislators elected to forgo any "wraparound" provision similar to that found in the Alberta Act and the PEI Act, a court could interpret this as the legislature's intention to exclude the use of a UFOC or disclosure document from another jurisdiction with a wraparound or addendum in Ontario. Accordingly, to avoid doubt, franchisors should prepare a specific Ontario disclosure document for use in that province, and prepare an Alberta and PEI wraparound or addendum based on the Ontario document.

**iv. New Brunswick**

No regulations have been issued under the New Brunswick Act, although it is expected that use of a wraparound or addendum will be authorized in the province.

**v. ULCC**

Similar to Ontario, neither the ULCC Act nor the regulations contain an express provision for the use of a wraparound or addendum. Interestingly, when PEI issued its discussion paper soliciting comments on its draft regulations, the discussion paper noted that the PEI Act was modeled after the ULCC Act, but specifically notes that it didn't follow the example of the ULCC regarding the omission of the express permission to use a wraparound. This suggests that the province didn't want the franchise legislation to create a disincentive to franchisors doing business in the small province, and it will be interesting to see which, if any, other provinces follow the ULCC's model on this point.

***8. Financial Statements***

The regulations made under the Ontario Act, the Alberta Act, the PEI Act and the ULCC Act all require that a franchisor include in its disclosure document a set of recent financial statements. The requirement is fairly consistent across the country.

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<sup>10</sup> P.E.I. Reg. EC2006-232.

### **i. Ontario**

The requirement under the Ontario regulation to include financial statements in a disclosure document is as follows:

Section 3:

- (1) Every disclosure document shall include,
  - (a) an audited financial statement for the most recently completed fiscal year of the franchisor's operations, prepared in accordance with generally accepted auditing standards that are at least equivalent to those set out in the *Canadian Institute of Chartered Accountants Handbook*;
  - (b) a financial statement for the most recently completed fiscal year of the franchisor's operations, prepared in accordance with generally accepted accounting principles that are at least equivalent to the review and reporting standards applicable to review engagements set out in the *Canadian Institute of Chartered Accountants Handbook*; or
  - (c) if a regulation has been made under subsection 13 (2) of the Act in respect of the franchisor, a declaration that the franchisor is exempt from the requirement to provide the financial statement described in clause (a) or (b), and that the franchisor meets the criteria prescribed for the purpose of that exemption.
- (2) Despite subsection (1), if 180 days have not yet passed since the end of the most recently completed fiscal year and a financial statement has not been prepared and reported for that year, the disclosure document shall include a financial statement for the previous fiscal year that is prepared in accordance with the requirements in clause (1) (a) or (b).
- (3) Despite subsection (1), if a franchisor has operated for less than one fiscal year or if 180 days have not yet passed since the end of the first fiscal year of operations and a financial statement for that year has not been prepared in accordance with the requirements in clause (1) (a) or (b), the disclosure document shall include the opening balance sheet for the franchisor.

### **ii. Alberta**

The requirement under the Alberta regulation to include financial statements in a disclosure document is as follows:

Section 3:

- (1) Financial statements of the franchisor must be prepared in accordance with generally accepted accounting principles for the jurisdiction in which the franchisor is based.
- (2) Financial statements must be either
  - (a) audited in accordance with the generally accepted auditing standards set out in the *Canadian Institute of Chartered Accountants Handbook*, or
  - (b) reviewed in accordance with the review standards and reporting standards applicable to review engagements set out in the *Canadian Institute of Chartered Accountants Handbook*.
- (3) The auditing standards and the review standards and reporting standards of other jurisdictions that are at least equivalent to subsection (2) are acceptable.
- (4) The financial statements must be for the most recently completed fiscal year.
- (5) If 180 days have not yet passed since the end of the most recently completed fiscal year and financial statements have not been prepared and reported on for that fiscal year, the financial statements for the previous fiscal year may be included.
- (6) If
  - (a) the franchisor has not completed one fiscal year of operation,

or

(b) 180 days has not yet passed since the end of the first fiscal year of operation and financial statements have not been prepared and reported on for that fiscal year, the disclosure document must include the franchisor's opening balance sheet.

### iii. PEI

The requirement under the PEI regulation to include financial statements in a disclosure document is as follows:

Section 5:

(1) Subject to section 6 and to an exemption order made under subsection 8(1) of the Act, every disclosure document shall contain financial statements of the franchisor that are prepared in accordance with the generally accepted accounting principles of the jurisdiction in which the franchisor is based.

(2) The financial statements must be either

(a) audited in accordance with the generally accepted auditing standards set out in the *Canadian Institute of Chartered Accountants Handbook*; or

(b) reviewed in accordance with the review and reporting standards applicable to review engagements set out in the *Canadian Institute of Chartered Accountants Handbook*.

(3) The auditing standards and the review and reporting standards of other jurisdictions that are at least equivalent to those referred to in subsection (2) are acceptable.

(4) The financial statements must be for the most recently completed fiscal year.

(5) Despite subsection (4), if 180 days have not yet passed since the end of the most recently completed fiscal year and financial statements have not been prepared and reported on for that fiscal year, the disclosure document shall contain the financial statements for the last completed fiscal year.

(6) Despite subsection (4), if a franchisor has operated for less than one fiscal year or if 180 days have not yet passed since the end of the first fiscal year of operations and financial statements for that year have not been prepared and reported on for that fiscal year, the disclosure document shall contain the opening balance sheet for the franchisor.

### iv. ULCC

The requirement under the ULCC regulation to include financial statements in a disclosure document is as follows:

Section 9:

(1) Every disclosure document shall contain,

(a) an audited financial statement for the most recently completed fiscal year of the franchisor's operations, prepared in accordance with the generally accepted auditing standards set out in the *Canadian Institute of Chartered Accountants Handbook*; or

(b) a financial statement for the most recently completed fiscal year of the franchisor's operations, prepared in accordance with generally accepted accounting principles and which complies with the review and reporting standards applicable to review engagements set out in the *Canadian Institute of Chartered Accountants Handbook*.

(2) Despite subsection (1), if 180 days have not yet passed since the end of the most recently completed fiscal year and a financial statement has not been prepared for that year, the disclosure document shall contain a financial statement for the last completed fiscal year that is prepared in accordance with the requirements of clause (1) (a) or (b).

(3) Despite subsection (1), if a franchisor has operated for less than one fiscal year or if 180 days have not yet passed since the end of the first fiscal year of operations and a financial statement for that year has not been prepared in accordance with the requirements of clause (1) (a) or (b), the disclosure document shall contain the opening balance sheet for the franchisor.

(4) Despite subsection (1), if the franchisor is based in a jurisdiction other than [insert jurisdiction], the disclosure document shall contain financial statements prepared in accordance with generally accepted accounting principles for the jurisdiction in which the franchisor is based if,

(a) the auditing standards or the review and reporting standards of that jurisdiction are at least equivalent to those standards described in clause (1) (a) or (b); or

(b) the auditing standards or the review and reporting standards of that jurisdiction are not at least equivalent to those standards described in clause (1) (a) or (b), but the disclosure document contains supplementary information that sets out any changes necessary to make the presentation and content of such financial statements equivalent to those of clause (1) (a) or (b).

(5) In a circumstance described in clause (4) (a) or (b), the disclosure document shall contain a statement that the financial statements contained in the disclosure document are prepared in accordance with generally accepted accounting principles for the jurisdiction in which the franchisor is based and that the requirements of clause (4) (a) or (b), as the case may be, are satisfied.

## **v. New Brunswick**

There are no draft regulations under the New Brunswick Act, but it is most likely that, when issued, the regulation will require disclosure of financial statements in substantially the same format as the other disclosure provinces.

## ***9. Exemption from Providing Financial Statements***

Ontario, Alberta and PEI's legislation provides certain exemptions from the requirement to provide financial statements in a disclosure document.

### **i. Ontario**

The exemption reads as follows:

Section 11:

(1) Pursuant to subsection 13 (2) of the Act, a franchisor that meets the following criteria is exempt from the requirement to include the financial information described in clause 3 (1) (a) or (b) or subsection 3 (2) or (3) of this Regulation in a disclosure document, subject to the conditions set out in subsection (3):

1. The net worth of the franchisor on a consolidated basis according to its most recent financial statements that have been audited or for which a review engagement report has been prepared,

i. is at least \$5,000,000, or

ii. have been audited or for which a review engagement report has been prepared is at least \$5,000,000.. is at least \$1,000,000, if the franchisor is controlled by a corporation whose net worth on a consolidated basis according to its most recent financial statements that

2. The franchisor,

i. in the five years immediately preceding the date of the disclosure document, has at least 25 franchisees engaging in business at all times in Canada

- ii. in the five years immediately preceding the date of the disclosure document, has fewer than 25 franchisees engaging in business at all times in Canada and has at least 25 franchisees engaging in business at all times in a single jurisdiction other than Canada,
  - iii. does not meet the requirements of subparagraph i or ii, but is controlled by a corporation that meets the requirements of subparagraph i, or
  - iv. does not meet the requirements of subparagraph i or ii, but is controlled by a corporation that meets the requirements of subparagraph ii.
3. The franchisor,
- i. has engaged in the line of business associated with the franchise continuously for not less than five years immediately preceding the date of the disclosure document, or
  - ii. is controlled by a corporation that meets the requirements of subparagraph i.
4. In the five years immediately preceding the date of the disclosure document, the franchisor, the franchisor's associates, and the directors, general partners and officers of the franchisor,
- i. in the case of a franchisor described in subparagraph 2 i or iii have not had any judgment, order or award made in Canada against any of them relating to fraud, unfair or deceptive practices, or a law regulating franchises, including the Act, or
  - ii. in the case of a franchisor described in subparagraph 2 ii or iv have not had any judgment, order or award made in Canada or in the jurisdiction referred to in subparagraph 2 ii against any of them relating to fraud, unfair or deceptive practices, or a law regulating franchises, including the Act.
- (2) Financial statements of a franchisor mentioned in paragraph I of subsection (1) shall,
- (a) be prepared in accordance with generally accepted auditing standards that are at least equivalent to those set out in the Canadian Institute of Chartered Accountants Handbook, if the financial statements are audited; and
  - (b) be prepared in accordance with generally accepted accounting principles that are at least equivalent to the review and reporting standards applicable to review engagements set out in the *Canadian Institute of Chartered Accountants Handbook*, if a review engagement report has been prepared for the financial statements.

The exemption is based on a self-assessment process. If a franchisor decides that it qualifies for the exemption, there is no requirement to notify or apply to any government agency for an exemption order, as was the case when the legislation was first introduced in Ontario. However, if challenged, the onus would be on the franchisor to show that it qualified for the exemption.

One practical problem that occurs with respect to the self-assessment of the exemption relates to the basis of the self-assessment. The evaluation of net worth as provided for in the regulation is to be based on the franchisor's "most recent financial statements." However, where the franchisor's financial statements are consolidated into, and are part of, the controlling corporation's financial statements, there may not be any financial statements for the franchisor from which such assessment can be made. While the controlling corporation could obtain a letter of advice or comfort from its auditors confirming that, in the course of preparing the controlling corporation's financial statements, they had access to and reviewed the records of the actual franchisor and that they are of the opinion that had financial statements been prepared for the franchisor (on

a review engagement or audited basis), the net worth of the actual franchisor would have been not less than \$1 000 000, there is still a risk of non-compliance with the regulation as the standards set out in the regulation have not been strictly met. Another option is to have statements prepared for the franchisor, although the cost and time required to do so may be considerable.

Under the Ontario Act and regulations, as originally enacted, the financial statements to be included in a disclosure document were required to meet the *Canadian Institute of Chartered Accountants Handbook* standards. However, amendments made on 1 July 2005 (and reflected in subparagraph (2) above) introduced an equivalency standard, which allows financial statements prepared in the franchisor's home jurisdiction to be used if they are equivalent to the Canadian standards.

## ii. Alberta

The Alberta regulation has a similar exemption for the requirement to include financial statements in a disclosure document:

### Section 1:

A franchisor is not required to include financial statements in a disclosure document given to a prospective franchisee

- (a) if the franchisor has a net worth on a consolidated basis according to its most recent financial statements, which have been audited or for which a review engagement report has been prepared,
  - (i) of not less than \$5 000 000, or
  - (ii) of not less than \$1 000 000 if the franchisor is controlled by a corporation that meets the requirements of subclause (i), and
- (b) if the franchisor
  - (i) has had at least 25 franchisees conducting business at all times in Canada during the 5-year period immediately preceding the date of the disclosure document,
  - (ii) has conducted business that is the subject of the franchise continuously for not less than 5 years immediately preceding the date of the disclosure document, or
  - (iii) is controlled by a corporation that meets the requirements of subclause (i) or (ii).

The exemption in Alberta is also based on a self-assessment process, but note two differences between the corresponding exemption in the Ontario Act: (A) the absence of the requirement that the standard of audit or review for the financial statements to be equivalent to the standards set out in the *Canadian Institute of Chartered Accountants Handbook*, and (B) the franchisor must meet the requirement to have twenty-five franchisees in Canada during the past five years, *or* has operated in Canada for not less than five years (or in either case is controlled by a corporation that meets these requirements). In Ontario, the franchisor must meet both requirements.

### iii. PEI

The exemption in the PEI Act is substantially similar to that found in the Ontario Act, although the net worth requirements are lower:

Section 6:

A franchisor is exempt from the requirement in clause 5(4)(b) of the Act and section 5 of these regulations to include financial statements in a disclosure document if:

(a) the franchisor has a net worth on a consolidated basis according to its most recent financial statements, which have been audited or for which a review engagement report has been prepared which

(i) is at least \$2,000,000, or

(ii) is at least \$1 000 000, if the franchisor is controlled by a corporation whose net worth on a consolidated basis according to its most recent financial statements that have been audited or for which a review engagement report has been prepared is at least \$2,000,000;

(b) the franchisor

(i) has at least 25 franchisees engaging in business at all times in Canada in the five years immediately preceding the date of the disclosure document;

(ii) has fewer than 25 franchisees engaging in business at all times in Canada and has at least 25 franchisees engaging in business at all times in a single jurisdiction other than Canada in the five years immediately preceding the date of the disclosure document;

(iii) does not meet the requirements of subclause (i) or (ii), but is controlled by a corporation that meets the requirements of subclause (i); or

(iv) does not meet the requirements of subclause (i) or (ii), but is controlled by a corporation that meets the requirements of subclause (ii);

(c) the franchisor

(i) has engaged in the line of business associated with the franchise continuously for not less than five years immediately preceding the date of the disclosure document;

or

(ii) is controlled by a corporation that meets the requirements of subclause (i); and

(d) the franchisor, the franchisor's associates and the directors, general partners and officers of the franchisor in the five years immediately preceding the date of the disclosure document;

(i) in the case of a franchisor described in subclause (b)(i) or (iii) have not had any judgment, order or award made in Canada against any of them relating to fraud, unfair or deceptive practices, or a law regulating franchises including the Act, or

(ii) in the case of a franchisor described in subclause (b)(ii) or (iv) have not had any judgment, order or award in Canada or in the jurisdiction referred to in subclause

(b)(ii) made against any of them relating to fraud, unfair or deceptive practices, or a law regulating franchises including the Act.

Accordingly, if a franchisee is exempt from providing financial statements in Ontario, the franchisor will meet the exemption requirements in PEI. In addition the PEI Act also gives the minister discretionary power to specifically exempt franchisors from including financial statements if the franchisor doesn't satisfy the criteria noted above.

#### **iv. ULCC**

Neither the ULCC Act nor the regulations provide any exemption from the requirement for a franchisor to include a copy of its most recent financial statements in the disclosure document. This topic was vigorously debated during the drafting of the act and the regulations, although the ULCC ultimately decided against including an exemption, instead opting to require the franchisor to provide to the franchisee copies of the financial statements regardless of the extent of operations and financial position of the franchisor.

It is noteworthy that this example was not followed in the PEI Act, and it remains to be seen whether the regulations ultimately issued under the New Brunswick Act will include an exemption. However, given that Ontario, PEI and Alberta include an exemption, it is possible that New Brunswick will follow suit, rather than being seen to create a disincentive for franchisors looking to do business in the province.

#### ***10. Confidentiality Agreements***

Section 5(11) of the New Brunswick Act, Section 5(9) of the PEI Act and Section 5(12) of the ULCC Act provide that neither a confidentiality agreement (subject to certain restrictions) nor an agreement designating a location, site or territory for a prospective franchisee are considered to be a "franchise agreement" in the context the timing of providing a disclosure document. Section 4(7) of the Alberta Act provides the same exceptions, though differently worded. In other words, a franchisor may require that the franchisee execute such agreements without being offside the fourteen-day waiting period requirement.

This provision will bring some relief to franchisors who have largely been unable to protect confidential information in the disclosure document when providing the disclosure document to franchisees in Ontario, as without such an exemption, a confidentiality agreement likely falls within the definition of a franchise agreement. Provided that the confidentiality agreement complies with the requirements of the New Brunswick Act or the PEI Act, as applicable, franchisors will be able to require franchisees in those provinces to enter into such agreements without risk of triggering any rescission rights.

#### ***11. Dispute Resolution***

Section 8 of the New Brunswick Act and Section 8 of the ULCC Act include a dispute resolution mechanism that can be utilized by any party to a franchise agreement. Once any party provides notice to any other party of a dispute, the parties must attempt to resolve the dispute within fifteen days (though query whether the duty of fair dealing applies to such attempt).

If the parties do not resolve the dispute, any party may require the other parties to attend mediation. The moving party may provide notice of mediation within thirty days after delivery of the notice of dispute but not before the expiry of the fifteen-day period for resolving the dispute as noted above. The procedure for mediation is prescribed in the regulations made under the ULCC Act and presumably will be described in similar regulations under the New Brunswick Act.

There is no equivalent section in either the Ontario Act, the Alberta Act or the PEI Act. Any mandatory dispute resolution would have to be included in the franchise agreement.

### ***12. Misrepresentations***

Section 7(5) of the Ontario Act provides for certain exemptions from liability for misrepresentation that are available to persons other than the franchisor. The Atlantic Legislation includes an exemption for liability for a misrepresentation in the disclosure document (for persons other than the franchisor) in situations substantially similar to the exemptions listed in the Ontario Act. However, the Atlantic Legislation includes an additional exemption for liability for a misrepresentation if: (i) the representation was purportedly made on the authority of a statement made by a public official (subject to certain conditions), or (ii) the person conducted an investigation sufficient to establish that there were reasonable grounds for him or her to believe that there was no misrepresentation and that the person indeed believed there was no misrepresentation. While category (i) may have limited practical application, category (ii) will be useful to a person who is being sued for misrepresentation, provided that such person can prove that he or she conducted a reasonable investigation into the matter. What is reasonable will undoubtedly depend on the nature of the misrepresentation and be decided on a case-by-case basis.

## **II. SUMMARY**

In summary, the PEI Act and the New Brunswick Act are largely similar to, and substantially follow the format of, the Ontario Act, which is conceptually similar to the Alberta Act. In addition, other provinces and territories may choose to adopt the ULCC Act as a basis for their franchise legislation to follow what appears to be an emerging trend of adopting relatively uniform franchise-specific legislation. This all bodes well for franchisors wanting to avoid having to deal with franchise legislation that is unique to each province. However, despite the apparent similarity, franchisors should be aware of the not-insignificant differences that will affect how they deal with franchisees in each province.