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CHAPTER 1

INTRODUCTION

A. SCOPE OF REPORT

This project considers whether legislation to regulate franchising should be enacted in Manitoba. The Manitoba Law Reform Commission received a suggestion in January 2006 that a review of possible reforms to franchise law in Manitoba would be valuable. As well, there has been occasional media attention focusing on the inequality between franchisors and franchisees and recently, on alleged franchising frauds in Manitoba.[1] In recent years, four provinces and several countries have enacted new or revised franchise legislation.

In May 2007, the Commission issued a *Consultation Paper on Franchise Law*, which asked whether franchise legislation is needed in Manitoba, and if so, what elements should be included in the legislation. The Commission invited public comment on the matters discussed for consideration by the Commission in preparation of its final report.

The Commission received a number of helpful submissions in response to the consultation paper, from franchisees, franchisors and franchise law practitioners. Also in response to the consultation paper, the Marcel A. Desautels Centre for Private Enterprise and the Law and the Asper Chair of International Business and Trade Law at the University of Manitoba organized a Franchise Law Symposium, held in Winnipeg on March 14, 2008. The symposium resulted in a productive exchange of ideas and views on franchise law.

This report provides an introduction to the history and various models of franchising, an overview of existing franchise regulation in Canada and other countries and a review of the elements of Canadian legislative regimes. The Commission recommends the enactment of franchise legislation in Manitoba and makes a number of further recommendations that Commissioners believe will protect the interests of franchisees and enable them to make more informed business decisions, while recognizing the commercial interests of franchisors. In accordance with *The Law Reform Commission Act*,[2] the Commission submits its report to the Minister of Justice and Attorney General for consideration.

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[1] For example, Alexandra Paul, "City man burned by pizza franchise scam" *Winnipeg Free Press* (February 12, 2007); Paul Turenne, "Bitter business tale: Pizza franchise turned out to be scam" *Winnipeg Sun* (February 12, 2007). See also T. Davis, "A town tackles a giant" *Winnipeg Free Press* (June 17, 1995) A17; residents of the Town of Oakville organized a rally to protest a new General Motors policy that was forcing a dealer to close his dealership and to press for legislation that would make it more difficult for franchisors to dictate terms to franchisees. According to the report, GM was requiring dealers to undertake expensive renovations, and had refused approval for the Oakville dealer to sell his dealership instead. In the article, NDP MLA Jim Maloway and the President of the Manitoba Motor Dealers Association advocated for franchise legislation in Manitoba.

[2] C.C.S.M. c. L95.

B. ACKNOWLEDGEMENTS

The Commission wishes to thank A.L. Weinberg, Q.C., of Myers Weinberg LLP in Winnipeg, Manitoba, who suggested that the reform of franchise law would be a useful topic for review, and who provided the Commission with submissions, case examples and reference material. The Commission also thanks Ian McNaught, a law student at the University of Manitoba in 2006, who conducted research and assisted in the preparation of the consultation paper that formed the basis for this report. As well, the Commission extends its appreciation to those who responded to the consultation paper, who included franchisees, franchisors, associations and practitioners in the area of franchise law, both within and outside of Manitoba. The submissions were of great assistance in preparing this report. A list of individuals and associations that provided submissions is found in Appendix A.

The Commission also thanks Professor Bryan Schwartz, University of Manitoba Faculty of Law, John Pozios, Director, Marcel A. Desautels Centre for Private Enterprise and the Law, and Leandro Zylberman, a law student at the University of Manitoba in 2007-08, who organized and hosted the 2008 Franchise Law Symposium. The symposium was well attended, and several panelists with experience in franchise law or franchising offered their comments and recommendations for Manitoba franchise legislation. A list of symposium panelists is included in Appendix B.

It must be noted, however, that the recommendations in this report are those of the Commission and do not necessarily reflect the views of those who provided their views.

CHAPTER 2

FRANCHISING OVERVIEW

A. GENERAL

Franchises are widespread in today's society. Consumers do business daily with a broad range of franchised brands - buying fast-food, coffee, gas and real estate, hiring cleaning services, booking vacations and having their taxes prepared. However, the popularity of franchising as a way of doing business is a relatively recent phenomenon.

In its earliest sense, a franchise was understood as a "special privilege to do certain things conferred by government on an individual or corporation, and which does not belong to citizens generally of common right".[1] This meaning is still relevant; the government grants franchises to companies such as telecommunications and utility service providers to encourage the development of a public good by the private sector. In the modern commercial environment, however, franchising now generally refers to a specific and prevalent method of doing business:

> In its simplest terms, a franchise is a license from [the] owner of a trademark or trade name permitting another to sell a product under that name or mark. More broadly stated, a "franchise" has evolved into an elaborate agreement under which the franchisee undertakes to conduct a business or sell a product or service in accordance with methods and procedures prescribed by the franchisor, and the franchisor undertakes to assist the franchisee through advertising, promotion and other advisory services.[2]

A franchise is a contract between two businesses, in which the franchisor grants the franchisee the right to operate its business system in return for payment of fees and royalties. The business system typically includes intellectual property (such as trademarks, trade names and logos), the right to sell products or services, access to business knowledge and methods, and other physical and intangible assets.[3] Franchisors may operate some of their units directly and franchise others.

A key element of a franchise is the ongoing relationship between the parties. The franchisor often provides continuing support or direction regarding the operation of the business. The franchisee agrees to sell the franchisor's product, often exclusively, and to comply with the franchisor's standards. While the franchisee is an independent business, it will usually be required to operate in a way that is substantially similar to or indistinguishable from the

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[1] *Black's Law Dictionary*, 6th ed., *s.v.* "franchise". For example, in ancient England the monarchy would grant a subject the right to collect taxes.

[2] *Ibid.*

[3] See Arthur J. Trebilcock, "Chapter 1: Introduction to Franchising" *Franchising 101* (Toronto: Ontario Bar Association, 2001), online: <http://www.oba.org/en/pdf/Franchising101.pdf>; J. Anthony Van Duzer, *The Law of Partnerships and Corporations*, 2nd ed. (Toronto: Irwin Law, 2003) at 20.

operation of the franchisor and its other franchisees.[4]

Franchising has been described as "an organizational choice for distributing goods and services":[5]

> As a form of business organization, franchising is seen as occupying a middle ground between two poles of the organizational continuum. At one end of the continuum is vertical integration (for example, a producer that owns its own retail outlets). At the other end is an isolated commercial transaction (for example, a producer that makes a one-time sale to a retailer). In franchising the vertical relationship, often between a supplier and a retailer, is continuous and sometimes intense. The franchisee may gain the good will associated with the franchisor's trademark, standards for the quality and style of operation associated with the mark, and perhaps from training and advice provided by the franchisor. Still, the capital and risk incentives for operation of individual outlets remain much like those of independently owned businesses. The franchisee risks its capital to own and operate an outlet. But, unlike in an independently owned business, a franchisee generally relinquishes a great deal of control over the outlet and must share with the franchisor the revenue generated by the outlet. Many franchisees pay an up-front franchise fee, continuing royalties based upon sales, and subject themselves to the franchisor's monitoring.[6]

B. HISTORY

The franchising concept dates back to the English Middle Ages, when the Crown, wanting to avoid the costs and administrative burden of hiring, paying and supervising tax collectors, granted to officials the right to collect and keep the Crown's taxes in return for a fee. Franchises were also granted for purposes such as fairs and markets; a franchise gave an individual or group monopoly rights over a specific activity in a location for a period of time. Usually the individual or group that received the franchise was required to make a payment in return, generally a share of the product or profit, which was called a royalty.[7] Later, in North America, governments granted private individuals and corporations the right to carry out activities that would otherwise be restricted to the government, to facilitate the development of infrastructure and services such as railroads, utilities and banking.[8]

Modern private sector franchising first appeared in the 1850s. The first franchise model is often attributed to the Singer Sewing Machine Company, which created an independent

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[4] Trebilcock, *ibid.*; Edward N. Levitt, *Distribution Networks and Agreements* (May 2002), online: Gowling Lafleur Henderson LLP <http://www.gowlings.com/resources/PublicationPDFs/Levitt_DistributionNetworks.pdf>.

[5] Warren S. Grimes, "Perspectives on Franchising: When Do Franchisors Have Market Power? Anti-Trust Remedies for Franchisor Opportunism" (Fall, 1996), 65 Antitrust L.J. 105 at 107.

[6] *Ibid.*

[7] Roger D. Blair & Francine Lafontaine, *The Economics of Franchising* (New York: Cambridge University Press, 2005) at 3.

[8] See generally Daniel F. So, *Canadian Franchise Law Handbook* (Markham, Ont.: LexisNexis Butterworths, 2005) at 9–17; Trebilcock, *supra* note 3; Frank Zaid, *Franchise Law* (Toronto: Irwin Law, 2005) at 2.

distributor network for its sewing machines. Over time, Singer developed mechanisms for greater control over the network, giving instructions for the operation of the offices and requiring detailed financial reporting.[9] Although the business model ultimately failed for Singer, the private sector franchising concept began to take hold.[10]

One of the first businesses to successfully employ the franchising concept was Coca-Cola. As the company expanded across the U.S., it licensed regional franchisee bottlers to produce and bottle soft drinks under its trademark. Coca-Cola's rapid expansion was funded by the franchisees, who in return received exclusive distribution territories and support.[11]

General Motors began distributing automobile inventory across the country through individual dealers in 1898. Dealers could purchase vehicles at a discounted price for resale and were granted regional franchise rights; in return they were required to sell only the products of a single manufacturer. This distribution method shifted to dealers some of the risks of market downturns, and proved to be successful for the automobile industry.[12]

In the 1930s, oil refiners licensed franchisee gasoline stations to former employee managers to distribute their products. The refiners found that the owner-dealers had a more personal interest in the success of their locations, and the companies saw larger profits from higher gas sales and from the rent from the properties. In Canada, the Canadian Tire franchise was also successfully established in the 1930s.[13]

During the Depression, individual retail merchants grouped together in order to cope more efficiently with the difficult economy and compete with large business chains.[14] Following the Second World War, franchising expanded to a number of new industries, including fast food restaurants, hardware and drug retailing (including Shoppers' Drug Mart in Canada) and motel and hotel services. There were high-profile failures associated with rapid expansion "as growth continued unprincipled and unregulated",[15] but by the 1970s, franchising had become a popular method of doing business and an enduring part of the U.S. and Canadian economies.

C. FRANCHISE ECONOMIC IMPACT

Franchising represents a significant portion of the Canadian economy. The Canadian Franchise Association has reported that franchising accounts for $90 billion per year in sales

[9] The McCormick Harvesting Machine Company developed a similar system of exclusive sales territories: Blair and Lafontaine, *supra* note 7 at 5-6.

[10] So, *supra* note 8 at 10.

[11] *Ibid.*; Trebilcock, *supra* note 3.

[12] So, *supra* note 8 at 11-12.

[13] *Ibid.* at 13-14.

[14] Trebilcock, *supra* note 3.

[15] Zaid, *supra* note 8 at 2.

nationally.[16] With respect to Ontario, Hoffman and Levitt have commented:

> The importance and impact of franchising on Ontario's economy today cannot be overstated. Franchising's share of the retail dollar is fast approaching 50%. It has moved from a somewhat novel alternative distribution option to one of the first distribution choices considered by a wide variety of businesses.[17]

In the U.S., a study commissioned by the International Franchise Association examining 2001 data found that there were more than 767,000 franchised businesses directly employing 9.8 million people, with a payroll of $229 billion and an economic output of nearly $625 billion. When the indirect impact of franchised businesses was measured, they generated more than 18 million jobs, or nearly 14 percent of all private sector jobs, and accounted for 11% of the private sector payroll and 9.5 percent of the private sector economic output, or more than $1.53 trillion. According to the study, when both direct and indirect forms of employment were combined, franchising generated one out of every seven jobs in the private sector.[18]

In Canada, it was reported in 2004 that there were 1,327 franchisors, 63,642 franchisees and annual franchising industry sales equivalent to approximately $90 billion U.S.,[19] or approximately 10% of Canada's gross domestic product. Franchising has been reported to account for one out of every five consumer dollars spent in Canada on goods and services and to employ over one million Canadians.[20]

D. TYPES OF FRANCHISE ARRANGEMENTS

There are two primary types of franchise arrangements: business format and product distribution franchises. Some commentators also include business opportunity franchises.

1. Business Format Franchise

The business format franchise is the modern type of franchising that emerged in the 1960s and is most commonly recognized as a franchise today. The franchisee exclusively

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[16] According to the Canadian Franchise Association, franchising crosses 42 sectors of the economy: Ontario Legislative Assembly, Standing Committee on Regulations and Private Bills, *Official Report of Debates (Hansard): Hearing on Bill 33, Franchise Disclosure Act, 1999* (March 8, 2000) at 1340 (Richard Cunningham, Canadian Franchise Association).

[17] Jeffrey P. Hoffman and Edward N. Levitt, *Recent Developments of Importance in Franchise Law* (December 17, 2005), online: Gowling Lafleur Henderson <http://gowlings.com/resources/publications.asp?pubid=1156>.

[18] International Franchise Association Education Foundation, *The Economic Impact of Franchised Business: Part II* by PriceWaterhouseCoopers (March 2004), online: <http://www.franchise.org/Files/EIS6_2.pdf>; "Franchises provide big boost to nation's economy: study measures jobs, payroll, overall output" 38:5 *Franchising World* (May 2006), online: <http://www.allbusiness.com/retail-trade/1185340-3.html>.

[19] So, *supra* note 8 at 5.

[20] Dan Caldarone and David J. Gray, "Advising the Start-up Franchisor" (Paper presented to The Domino Effect: 6th Annual Franchising Conference, Ontario Bar Association, November 16, 2006) at 2.

identifies with the franchisor, and adopts its entire business system, including its product, brand name, operating manual and marketing strategy. There is "an almost complete merging of the business identity of franchisee and franchisor, so that the public perceives each franchised outlet as part of a larger chain of identical outlets, all offering the same high quality goods and services".[21] Examples include hotels and fast food outlets such as Tim Hortons and McDonalds.

The unit franchise is the simplest and most popular business format franchise. In this model, the franchisor licenses the franchisee to operate a single franchise business in a specific location or territory. The franchisee usually pays an initial franchise fee and ongoing royalties based on a percentage of gross sales. The agreement also usually requires the franchisee to contribute to an advertising fund, and may contemplate multiple franchises, so that the franchisee has the option to acquire additional franchises or rights of first refusal.[22] There are also variations:

- In an affiliation or conversion franchise, the franchisor absorbs an independent business in the same field. The business agrees to conduct future operations under the franchisor's model.[23]

- A combination franchise joins "two or more distinct and complementary franchise systems in physical or functional conjunction",[24] usually involving the installation of an outlet of one system into an outlet of the "host" franchise system.

There are also forms of territorial franchising, in which rights are granted for an entire territory, such as a city, province or all of Canada:[25]

- In an area representation franchise, the franchisor retains an independent representative to seek prospective franchisees and carry out the franchisor's obligations within a defined area, in return for a share of the revenue. However, the franchise agreement is between the franchisee and franchisor, and not the representative.[26]

- In an area development franchise, the franchisor grants a franchisee the right to set up multiple outlets within a geographical area. The area development agreements generally deal with the terms of the franchise expansion and the number of outlets to be established, while the details of the individual outlets are governed by unit franchise agreements.[27]

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[21] Trebilcock, *supra* note 3 at 2.

[22] See Leonard H. Polsky, "Search continues for multiple unit franchisees", 24:21 *Lawyers Weekly* (October 8, 2004).

[23] Trebilcock, *supra* note 3 at 3.

[24] *Ibid.*

[25] Polsky, *supra* note 22.

[26] Trebilcock, *supra* note 3 at 3.

[27] *Ibid.* at 2.

- In a master franchising arrangement, the franchisor grants a master franchisee the right to recruit others and sell and service sub-franchises within a specified territory. The maintenance of exclusive rights to the territory depends on a performance schedule being met.[28] A master franchise creates a three-tiered relationship between the franchisor, master franchisee (or sub-franchisor) and sub-franchisee (or unit franchisee). There is a contract between the franchisor and the master franchisee and between the master franchisee and sub franchisees, but not between the sub-franchisee and the franchisor.[29] However, the franchisor receives revenues earned from the operations of the franchises and from sharing the franchise fees or royalty payments made to the master franchisee.

Finally, in a joint venture franchise, a franchisor and franchisee enter into a joint venture in which the franchisor grants a unit, area development, or master franchise to the joint venture entity.

2. Product Distribution Franchise

In a product distribution franchise, the franchisee is identified with the manufacturer or supplier to some degree, but also retains a distinct identity; examples are soft drink bottlers and automobile dealerships.[30] The franchisee obtains a licence to market and sell products within an exclusive distribution area, and may be encouraged or required to deal primarily with the franchisor's goods or services. Otherwise, the franchisor exercises less control than in a business format franchise, and the franchisee is usually free to choose its business style and distribution technique.[31]

3. Business Opportunity Franchise

In a business opportunity franchise, the franchisor grants the franchisee the right to sell goods and services provided by the franchisor. The franchisor may also provide location assistance. Examples of business opportunity franchises are vending machines and amusement games.[32]

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[28] Polsky, *supra* note 22.

[29] Trebilcock, *supra* note 3 at 2.

[30] Zaid, *supra* note 8 at 6; for example, an automotive group may operate a number of dealerships and be associated with several manufacturers, but maintain a distinct identity.

[31] Trebilcock, *supra* note 3 at 1-2.

[32] Zaid, *supra* note 8 at 6.

E. FRANCHISE ADVANTAGES AND DISADVANTAGES

A significant attraction of the franchise arrangement for the franchisee, particularly for the first time business owner, is the opportunity to enter the marketplace without assuming the degree of risk usually associated with startup enterprises. Business risks can be reduced where there is an established franchisor that offers a solid image, a recognized product or service with a developed market and a successful business system for the marketing and sale of the product or service. The franchisor generally has a vested interest in the success of the franchisee, and often provides detailed training, ongoing advice and mentoring and assistance in the event of a crisis.[33] The franchisee can learn the details of establishing and operating a business in a shorter time,[34] and continues to benefit from the franchisor's ongoing product research and development and advertising and promotional programs. The franchisee often also shares volume discounts available with bulk purchasing through the franchisor. As well, financial institutions are often more willing to provide business loans to franchised businesses.[35]

For the franchisor, franchising allows business expansion with little capital investment; expansion can be more rapid, as it is largely financed by franchisees.[36] Franchising also provides an ongoing source of revenue from franchise fees or royalties. Franchise unit owners may have a higher stake and level of commitment to the success of the business than do employed managers, and in the long term, the franchisor benefits from a competent franchisee's ability to attract future franchisees and increase the goodwill of the overall system.

While there are many examples of successful and profitable franchise relationships, the model also has disadvantages and risks. The franchisor gives up some control and profit opportunity by not operating its own outlets, in the expectation of greater profits through expansion.[37] The franchisor's reputation is at risk, as the general public will often not distinguish between individual franchise outlets and the larger organization. Franchisee selection can be difficult and time consuming,[38] and an incompetent or unsuccessful franchisee can damage the established goodwill of the franchise by providing substandard products or services.

To manage these risks, the franchisor will usually attempt to ensure that each franchisee maintains minimum standards with respect to the appearance and operation of its business. Franchisees are generally required to comply strictly with the operational methods established by

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[33] For a useful discussion of the advantages and disadvantages of buying a franchise see Government of Canada, *Tips on Buying a Franchise*, online: Canada Business - Services for Entrepreneurs <http://www.canadabusiness.ca/servlet/ContentServer?cid=1084286449074&pagename=CBSC_AB%2Fdisplay&lang=en&c=GuideFactSheet>.

[34] Edward N. Levitt, *The Origins of Franchise Disputes* (December 18, 2005), online: Gowling Lafleur Henderson LLP <http://www.gowlings.com/resources/publications.asp?Pubid=1143&lang=0>.

[35] So, *supra* note 8 at 7.

[36] *Ibid.* at 5.

[37] Caldarone and Gray, *supra* note 20 at 6-7.

[38] *Ibid.* at 7.

the franchisor,[39] and are frequently required to purchase supplies and inventory directly from the franchisor or from a designated supplier.[40]

The requirements imposed by the franchisor increase its ability to exercise quality control, limit the ability of franchisees to "free-ride" (a franchisee's attempt to benefit from the franchisor's reputation without doing its part to maintain standards)[41] and often increase the buying power of the franchisees. They also allow the franchisor to maintain consistency and a shared identity throughout the franchise system, in recognition that the strength of a franchise network is often less attributable to the absolute quality of its products than to its ability to offer a uniform product or experience at a reasonable price.[42] However, requirements for strict compliance may also stifle creative initiative by franchisees that otherwise could enhance the overall business and reputation of the franchise.[43] A franchisor may impose onerous obligations, exercise an excessive degree of control, fail to carry out effective marketing and promotion activities or disproportionately shift business risks and impose unreasonable product costs to the franchisee, making it difficult or impossible for the franchisee to carry on business effectively.

It has also been suggested that there is a "myth of high profitability".[44] Franchising is associated with a widespread perception of reduced risk, and it is often true that a mature and established franchise will present lower risk and the prospect of higher returns to an investor than an independent start-up business. Mature franchise opportunities command higher fees as a result. However, analyses of franchising in the U.S. suggest that "franchising is growing in real terms at best at a rate similar to that of the economy as a whole. This is inconsistent with the extravagant claims made by the trade press throughout the 1980s and 1990s".[45] As well, the majority of franchised systems are in fact relatively small, with fewer than 50 units, and consequently do not offer the main advantages generally associated with purchasing a franchise – a tested business format and a widely recognized brand.[46] New franchise outlets tend to be in high-risk areas of business with marginal return, and fail at a rate at or above the rate for other

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[39] Levitt, *Distribution Networks and Agreements*, *supra* note 4. As a result franchise arrangements are frequently long and complex and include a large number of secondary agreements, such as subleases and trademark, security and confidentiality agreements.

[40] So, *supra* note 8 at 7. So notes that volume purchasing is frequently a contentious issue; while the associated discounts may benefit franchisees, often rebates are paid directly to the franchisor and the franchisees do not directly benefit.

[41] Grimes, *supra* note 5 at 109-110.

[42] Blair and Lafontaine, *supra* note 7 at 117-118. The authors note that franchisees are generally aware of the value of uniformity, and will complain to their franchisor about under-performing outlets that ultimately impact negatively on the franchise and other franchisees.

[43] Grimes, *supra* note 5 at 110.

[44] *Ibid*. at 130.

[45] Blair and Lafontaine, *supra* note 7 at 52.

[46] *Ibid*. at 53.

small businesses.[47] On the other hand, a start-up franchise may present an opportunity for growth.

As Blair and Lafontaine conclude:

> [t]he data contradict the notion that investing in a franchised business is a risk-free or very low-risk endeavor. In fact, high franchisor failure rates suggest that joining a young or new franchised system is probably *more* risky than starting one's own business. Success in this case depends not only on one's own good ideas, resourcefulness, and dedication, but also on the capacity of the franchisor and the other franchisees to pull things together. The upside of joining a new franchise system also is potentially very high. Those who joined McDonald's when it was a fledgling chain have profited handsomely from this decision. When one joins an established chain, the probability of failure is lower but so is the probability that the venture will be hugely profitable … Franchisees that invest in small franchised systems must be buying in the hopes that the chain will grow and develop further. This is a fairly risky endeavor and must be recognized as such.[48]

In the end, both parties to the franchise relationship assume the ultimate risk of costly litigation should the franchise relationship prove unsuccessful.

F. THE FRANCHISE LEGAL RELATIONSHIP

1. Potential for Conflict

The relationship between the parties to a franchise agreement is often compared to a marriage: the parties depend on each other for their continued well being, the relationship is intended to continue for a lengthy period of time, and the arrangement is intended to be satisfactory to both parties.[49]

While franchisors and franchisees generally share a common desire to succeed, there is also considerable potential for conflict between them. The parties frequently have dramatically unequal bargaining power: the franchisor may have more extensive business and franchising

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[47] Grimes, *supra* note 5 at 123-124 and 130-131. See also U.S. Census Bureau, Center for Economic Studies, *Survival Patterns Among Newcomers to Franchising* (Discussion Paper CES-WP-97-5) by Timothy Bates (Washington, D.C.: Bureau of the Census, May 1997), online: <http://www.ces.census.gov/index.php/ces/1.00/ces papers?limit=10&search_where=d2hlcmUgeWVhcihwdWJsaWNhdGlvbl9kYXRlKT0xOTk3#table>; the study found that among "true newcomers" (young franchisee units not owned by mature multi-establishment franchisees), franchise survival rates were low and that the purchase of a franchise was not likely to reduce the risks faced by a new business.

[48] Blair and Lafontaine, *supra* note 7 at 44, 53 [emphasis in original].

[49] Larry Weinberg, "Chapter 2: The Franchise Relationship" *Franchising 101* (Toronto: Ontario Bar Association, 2001) at 1, online: <http://www.oba.org/en/pdf/Franchising101.pdf>. A 1995 review of the Canadian franchise industry noted "In some chains, especially those that are doing well, the connections can be quite strong, and stable. In others – and not necessarily just those franchises that are faring poorly – the relationship resembles a failing marriage, complete with suspicion, poor communications and the presence of lawyers.": John Lorinc, *Opportunity Knocks: The Truth About Canada's Franchise Industry* (Scarborough, Ont.: Prentice Hall Canada, 1995).

experience and generally has control over the terms of the franchise agreement, while the franchisee may have little business experience and, in any event, often must "take or leave" the franchise agreement as offered.[50] The franchisee must rely to some extent on the franchisor's representations with respect to the potential for business success, and some suggest that "all too often, the franchisor feels compelled to exaggerate the expected success of the franchise to make a sale".[51] In some cases, disreputable franchisors use high-pressure sales tactics and provide inaccurate or misleading financial information. When problems occur in the franchise, a franchisee suffering business difficulties will be less likely than the franchisor to have the financial resources available to fund litigation.

There can be a significant imbalance in the amount and quality of information available to the parties during negotiations and at the time the franchise agreement is signed. For a franchisor that is so inclined, the pre-contract period can be viewed as one with substantial incentives for opportunism:

> In recruiting an investor to open up a new franchise outlet a franchisor is, to a large degree, gambling with someone else's money … [F]ranchisors gain financially when an investor opens a new outlet, perhaps even if that outlet fails. Some franchisors may have invested minimally in the franchise system, but even those who have a large stake in the system may commit little or no resources to a new outlet. Indeed, the franchisor may receive an up-front franchise fee and, thus, may reap immediate financial gain even if the outlet fails quickly. In the event of failure, the franchisor may be the only buyer for the franchisee's capital equipment, and may do so at a deeply discounted price, perhaps reselling it to a future franchisee at a substantial markup.[52]

The franchisee continues to be at a disadvantage in relation to the franchisor in terms of access to information and control of operations throughout the franchise relationship. In many cases, franchisees are somewhat locked into the relationship by high "sunk costs", or invested funds that cannot be recovered if the franchise relationship ends. These costs mean that these franchisees will be disinclined to walk away from the franchise even in the case of reduced revenues and a poor relationship with the franchisor.[53] Even when a franchise is viable, high expectations arising from early projections may become a source of friction.[54] As Blair and

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[50] Blair and Lafontaine note, with respect to the U.S., that it is also important to recognize that not all franchisees are single-unit operations; several multi-unit franchisees operate large chains and may be larger than most franchised chains: *supra* note 7 at 53.

[51] Levitt, *The Origins of Franchise Disputes*, *supra* note 34. For example, Levitt suggests that "it is rare to see a franchise pro forma statement which contemplates a loss in the first few years of operation, as realistic as that may be".

[52] Grimes, *supra* note 5 at 124-125.

[53] Grimes, *supra* note 5 at 125. Grimes presents a thorough discussion of the incentives that may exist for a franchisor to act contrary to the interests of a franchisee. For example, a franchisor may decide to open an additional outlet in a territory, even if it decreases the sales of existing outlets, if the franchisor's overall revenue will increase. On the other hand, while the incentives of the franchisor may lean toward too much expansion, franchisees may have incentives leading them to oppose expansion, even when it has a favourable impact to the overall franchise.

[54] Levitt, *The Origins of Franchise Disputes*, *supra* note 34.

Lafontaine note:

> Because it works well most of the time, we expect that franchising will continue to flourish in the world economy. At the same time, however, we know from economic principles that franchise relationships are by their very nature fraught with many difficulties arising essentially from differences between the needs and goals of the franchisors and those of the franchisees.[55]

Various reviews of franchisor-franchisee disputes in Canada, the U.S. and Australia have identified a number of areas of conflict relating to the information and power imbalance in the relationship.[56] The issues include:

- lack of pre-contract disclosure;
- deceptive practices, including misrepresentation of the nature of the franchise, the range of supplies, equipment and training to be provided in the franchise package, the value and profitability of the franchise and the franchisor's stability and prior experience;
- unfair contract terms arising from a refusal by franchisors to negotiate the terms and conditions of contracts (the "take it or leave it" contract);
- complexity of documentation;
- excessive prices charged for mandatory goods and equipment supplied by franchisors or other providers to franchisees, even when items are available more cheaply from alternative suppliers;
- hidden rebates and commissions received by franchisors from required suppliers;
- encroachment by the franchisor on the franchisee's geographic trading area;
- franchisor-imposed system wide changes that bear significant cost;
- failure to provide adequate service and support to franchisees;
- substantial increases to renewal fees;
- use of advertising levies for non-advertising purposes;
- transfer and renewal restrictions and franchise renewals on different and more onerous terms; and
- unfair terminations.[57]

On the other hand, franchisor representatives have noted that the characterization of franchising issues can be one-sided and ignore the difficulties that can be caused by franchisees:

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[55] Blair and Lafontaine, *supra* note 7 at xi.

[56] See for example Lorinc, *supra* note 49; Grimes, *supra* note 5; U.S. Federal Trade Commission, *The Franchise Rule* (Statement before the U.S. House of Representatives, Committee on Energy and Commerce, Subcommittee on Commerce, Trade and Consumer Protection, June 25, 2002), online: <http://www.ftc.gov/os/2002/06/020625 bealesfranruletest.htm>; Austl., Commonwealth, House of Representatives, Standing Committee on Industry, Science and Technology, *Finding a Balance: Towards Fair Trading in Australia* (May 26, 1997), online: <http://www.aph.gov.au/HOUSE/committee/Isr/Fairtrad/report/contents.htm>.

[57] Recent media reports of lawsuits filed by franchisees of the Quiznos food chain in the U.S. vividly illustrate a range of problems alleged by franchisees: see Julie Creswell, "When Disillusion Sets In" *The New York Times* (February 24, 2007), online: <http://www.nytimes.com/2007/02/24/business/24quiznos.html >.

> [L]ittle mention is made in debate about potential franchisees wanting to "get into" the franchise system by misrepresentation of part or more of their small business history, financial position, work experience, level of commitment, product or service knowledge and other necessary criteria. In mature franchise systems, there appears to be an increase in incidents of this.[58]

One commentator eloquently summed up his views:

> Good franchising is very good. It is undoubtedly the most efficient, effective distribution system ever invented. It is the greatest invention of Western capitalism since the invention of the corporation. Good franchising is so much better than independent small business operation and bad franchising is so much worse.[59]

2. Legal Aspects

In the absence of legislation, the relationship between the franchisee and franchisor is governed by the terms of the franchise agreement and the law of contract. The rights and duties of each party arise from the contract, and general contract law principles, such as *caveat emptor* (buyer beware) and the right to act in one's own interests, apply. A party may have a right to rescission of the agreement or to damages on grounds such as breach of contract, misrepresentation, breach of warranty or *error in substantialibus* (a fundamental error in the character or substance of a thing sold).[60]

Franchises have at times been asserted to create employment relationships, most frequently in cases where the franchisor exercises significant control over daily operations.[61] A study of Australian franchise failures found that "despite the franchise agreement stating very clearly that the franchisee is not an employee of the franchisor, it appears that some franchisees regard themselves as employees".[62] As well, in some circumstances the franchisor-franchisee relationship has been argued to be fiduciary in nature, so that the franchisor owes a special duty

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[58] Franchise Association of Australia and New Zealand, Submission No. 143 to Austl., Commonwealth, House of Representatives, Standing Committee on Industry, Science and Technology, quoted in Standing Committee on Industry, Science and Technology, *supra* note 56 at 93, n. 16.

[59] Professor Andrew Terry, Transcript of Evidence to Austl., Commonwealth, House of Representatives, Standing Committee on Industry, Science and Technology at 92, quoted in Standing Committee on Industry, Science and Technology, *supra* note 56 at 83.

[60] See for example *Esso Petroleum Co. v. Mardon*, [1976] 2 All E.R. 5 (C.A.); *Kim v. Shefield & Sons – Tobacconists Inc.* (1990), 30 C.P.R. (3d) 111 (B.C.C.A.); *Nasirbegh v. Triple 3 Holdings Inc. (c.o.b. 3 for 1 Pizza & Wings)*, [2003] O.J. No 751 (QL) (S.C.J.).

[61] Weinberg, *supra* note 49 at 3. Weinberg notes that claims of an employment relationship most frequently arise where employment-type severance and other termination benefits are being claimed by the franchisee, especially where the franchisee has little to no capital invested. In some cases, involving restrictive franchise agreements, the arguments have been successful: see *Head v. Inter Tan Canada Ltd.* (1991), 5 O.R. (3d) 192 (Gen. Div).

[62] CPA Australia, *When the Franchisor Fails* (Research Report by the University of New South Wales) by Jenny Buchan (Melbourne: CPA Australia, 2005) at 3, online: <http://www.cpaaustralia.com.au/cps/rde/xbcr/SID-3F57FEDF-CDC3599/cpa/200602_franchisor.pdf>.

of care toward the franchisee.[63] The Supreme Court of Canada addressed this issue in 1975, in *Jirna v. Mister Donut*,[64] affirming the finding of the Ontario Court of Appeal that, in the circumstances, no fiduciary relationship existed between the parties. In *Jirna*, the franchisee's representatives in the negotiations were experienced in business and under no serious disparity relative to the franchisor, and the provisions in the franchise agreement fell considerably short of the relationship of trust and confidence that would be necessary to create a fiduciary obligation. However, the court did not rule out the possibility of a fiduciary relationship arising in a different franchise situation.

In most circumstances, a franchise agreement is a commercial contract between independent parties with no fiduciary or employment obligations. However, there is no hard and fast rule; a commercial agreement is not immune from the imposition of fiduciary duties,[65] and it is possible that fiduciary or employment obligations might be found to exist in a franchise relationship in exceptional circumstances.

The typical franchise relationship is distinct from other commercial relationships in some respects, however. In *Shelanu*,[66] a leading franchise case, the Ontario Court of Appeal noted that, in accordance with *Jirna*,[67] the relationship between a franchisor and franchisee would not normally be characterized as a fiduciary one, but it does have unique characteristics that set it apart from an ordinary commercial relationship. The characteristics are similar to the factors outlined by the Supreme Court of Canada in *Wallace v. United Grain Growers*[68] that give rise to a good faith obligation in the context of an employment contract. Like the situation in *Wallace*, a franchisee does not usually have equal bargaining power to the franchisor, the franchise contract is imposed on the franchisee, who is usually unable to negotiate more favourable terms, and the relationship continues to be affected by the power imbalance, in that the franchisee must submit to inspections and audits and otherwise comply with the franchisor's requirements.

In *Shelanu*, the Court of Appeal held that, in the absence of franchise legislation, these characteristics give rise to a common law duty upon the parties to a franchise relationship to act in good faith. The franchisor must have regard to the legitimate interests of the franchisee. However, the franchisor may act in its own interests so long as it deals promptly, honestly, fairly and reasonably with the franchisee. In the circumstances, the court found that the franchisor had breached its duty of good faith, but the breaches did not amount to a fundamental breach of the franchise agreement. As a result, the franchisee was not entitled to treat the agreement as at an end.

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[63] Weinberg, *supra* note 49.

[64] [1975] 1 S.C.R. 2, aff'g (1971), 22 D.L.R. (3d) 639 (Ont. C.A).

[65] *530888 Ontario Ltd. v. Sobeys Inc*., [2001] O.J. No. 318 at para. 9 (QL) (S.C.J.).

[66] *Shelanu Inc. v. Print Three Franchising Corp.* (2003), 64 O.R. (3d) 533 (C.A.) [*Shelanu*]. Ontario's *Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3 requires parties to a franchise agreement to act in good faith. However, the facts giving rise to the dispute occurred before the Act came into force and the court found that it was not necessary to decide whether the Act applied in this case.

[67] *Supra* note 64.

[68] *Wallace v. United Grain Growers Ltd. (c.o.b. Public Press)*, [1997] 3 S.C.R. 701.

The distinctive nature of the franchise agreement also leads to certain principles of interpretation. Under the principle of *contra proferentem*, a court will construe an ambiguous clause in a contract against the person who prepared it.[69] A franchise agreement is also often a contract of adhesion. A contract of adhesion is, in general, a written contract drafted by one party on a form regularly used by the drafter and presented to the other party on a "take it or leave it" basis; the other party enters into relatively few such transactions in comparison with the drafter and his or her principal obligation is the payment of money. *Contra proferentem* applies, but even in the absence of ambiguity, a contract of adhesion is interpreted strictly against the party presenting it.[70]

As well, many other areas of law may affect a franchise, depending on the circumstances and the nature of the business conducted; these may include competition, consumer protection, privacy, tax, bankruptcy, intellectual property and personal property security law.[71]

3. Manitoba Experience

There do not appear to be reliable quantitative data on the experience of franchisors and franchisees in Manitoba. A review of court decisions in recent years does illustrate the nature of some franchise disputes that reached resolution through litigation, however. For example, the 2006 case of *Halligan v. Liberty Tax Service Inc.*[72] provides a glaring example of franchisor intimidation tactics. In *Halligan*, the franchisor had decided to change the name of the franchise system, and pressured the franchisee to also change its business name. The franchisee refused, as he was entitled to do under the franchise agreement. The franchisor then withdrew its funding for tax discounting services without notice, purported to terminate the franchise agreement and established its own tax services within the franchisee's exclusive territories. The franchisor breached a court injunction that restrained it from acting in a manner inconsistent with the franchisee's rights and harassed the franchisee in a manner that the court noted "is indicative of the disdain Liberty has shown for Halligan and the court process throughout".[73] The court found that there was an attempt by the franchisor to "bludgeon Halligan into submission",[74] along with flagrant and repetitive breaches of the injunction. Liberty's actions were outrageous and high-

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[69] *Black's Law Dictionary*, 6th ed., *s.v.* "contra proferentem".

[70] See the discussion in *Halligan v. Liberty Tax Service Inc*., 2003 MBQB 174, 36 B.L.R. (3d) 75 at paras. 15-16.

[71] For a thorough discussion of several areas of law as they may impact on a franchise, see Zaid, *supra* note 8, and Peter Snell and Larry Weinberg, eds., *Fundamentals of Franchising – Canada* (Chicago, Ill: American Bar Association, 2005). See also John L. Rogers and Andraya Frith, "Piling On: Other Laws Affecting Franchising" (Paper presented to The Domino Effect: 6th Annual Franchising Conference, Ontario Bar Association, November 16, 2006).

[72] S*upra* note 70; supplementary judgment 2006 MBQB 75, [2006] 8 W.W.R. 97 (Man. Q.B.).

[73] *Supra* note 70 at para. 11.

[74] *Ibid.* at para. 2.

handed and the imbalance of power was stark. In light of this, in addition to compensatory damages of nearly $85,000, the court granted punitive damages of $200,000.

The case of *Prairie Petroleum Products Ltd. v. Husky Oil Ltd*.[75] dealt with a unilateral change to business operations by an oil company.[76] A change in Husky's pricing formula for fuel meant that the distributor could not offer a competitive price during the peak agricultural season, and the distributor lost sales. The court held that the change was a fundamental breach of contract and that the clauses in the contract that purported to exclude Husky's liability were not enforceable on the basis of unconscionability, unfairness and unreasonableness; the clauses benefited the large and commercially sophisticated company that had prepared the agreement, and enforcing them would lead to an unfair and unreasonable result. The plaintiffs were entitled to treat the agreement as terminated.

In *2909333 Manitoba Ltd. v. 616768 Saskatchewan Ltd*.,[77] the matter before the court was a motion related to examinations for discovery, but the allegations of the franchisees[78] included that the franchisor received benefits from suppliers contrary to its representations, wrongfully appropriated allowances for tenants' improvements, did not provide the required accounting and manuals and misrepresented sales and profits. In another case dealing with preliminary matters regarding where and how multiple claims would proceed, franchisee claims included "inaccurate forecast numbers, misrepresentation of profit, unreasonable construction costs, misrepresentation with respect to tenant inducements or improvements, payment of excess rent over actual rental costs, overstocking and failure to obtain the best possible prices from suppliers".[79] One egregious case involved the sale of a number of non-existent franchises to individuals interested in becoming dealers of office supplies. The "franchisor" was convicted of several offences, including 30 counts of fraud over $5,000.[80]

In *Print Three Franchising Corp. v. McLennan Printing Inc*.,[81] the Manitoba Court of Appeal found in favour of the franchisor. The franchisee had stopped paying royalties and fees to the franchisor and purported to terminate the franchise agreement, and was carrying on substantially the same business under a new name. The franchisees alleged that the franchisor had fundamentally breached the agreement by failing to provide pre-opening publicity, training and useable desktop publishing equipment. The Court of Appeal held that the franchisee was not

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[75] [2006] 11 W.W.R. 606 (QB).

[76] Although the agreement between the parties is not described as a franchise, many distributorship agreements are included in the definition of "franchise" in franchise legislation.

[77] (2006), 200 Man. R. (2d) 161(QB).

[78] Note that the facts had not been determined by the court.

[79] *1279022 Ontario Ltd. v. Posen* (2003), 179 Man. R. (2d) 108 (QB), rev'd (2004) 184 Man. R. (2d) 308 (C.A.).

[80] *R. v. Wuckert* (1999), 137 Man. R. (2d) 1, appealed against sentence only (2000), 145 Man. R. (2d) 181. On the other hand, in a 1995 Manitoba case, the court held that the franchisee had fraudulently converted profits by carrying on business activity that he kept secret from the franchisor: *Imasco Retail Inc. (c.o.b. Shoppers Drug Mart) v. Blanaru* [1995] 9 W.W.R. 44 (Man. Q.B.); aff'd [1997] 2 W.W.R. 295 (Man. C.A.).

[81] (2001), 153 Man. R. (2d) 32.

deprived of substantially the whole benefit that the parties intended it to obtain from the contract, and so the franchisor's actions did not amount to a fundamental breach. The court awarded damages to the franchisee for inadequate printing equipment, hardware and software, but also ordered the payment of the outstanding royalties and advertising fees.

A review of court decisions is unlikely to provide an accurate representation of franchise disputes, however. Many franchise agreements require arbitration and disputes would not reach the courts. More importantly, litigation is costly, and the ability of a party to an unsuccessful business relationship, particularly the franchisee, to fund an action may be very limited. The franchisee in *Halligan v. Liberty Tax Service Inc.*[82] observed in response to our consultation paper that small business owners tend not to have the resources "to fight a lengthy and costly litigation and at the same time fend off actions of the protagonist designed to inhibit and undermine the abilities of the small business to operate profitably".[83] Another respondent noted that "[f]ranchisees, unable to afford litigation to resolve disputes, have been forced to close their doors affecting jobs and the local economy". [84]

The Commission received several examples of Manitoba franchise disputes from franchisees and legal practitioners during its review. The material included allegations that some Manitoba franchisors:

- used pressure tactics upon the signing of the agreement and failed to provide contact information for other franchisees as requested;
- misrepresented that business assets were free of liens and that trade accounts were satisfied;
- did not provide promised business support and training;
- misrepresented establishment and operating costs;
- required the use of suppliers that provided substandard equipment and that paid a rebate to the franchisor;
- did not supply promised equipment or supplied faulty equipment;
- restructured franchise operations to focus on services that were more financially beneficial to the franchisor than to the franchisees;
- did not respond to requests for meetings;
- required existing franchisees to sign new more restrictive franchise agreements which, among other things, resulted in franchisees being unable to purchase more than 5% of their product or produce from local suppliers – franchisees that did not sign received notices of termination or faced non-renewal of their agreements;
- unilaterally increased franchise fees or royalty rates and changed pricing programs in a manner that was more profitable for the franchisor but was not sustainable for the franchisee;

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[82] *Supra* note 70.

[83] Submission by T. Halligan (February 4, 2008) at 2.

[84] Submission by the Canadian Federation of Independent Grocers (August 2007) at 3.

- established a corporate website to solicit orders and did not allocate the orders among franchisees on an equitable basis; and
- located new corporate and franchised outlets within the market areas of existing franchisees.

Respondents noted that franchisees lack bargaining power and are unable to influence the content of franchise agreements, and that "the nature of franchise contracts is such that, unlike traditional business contracts, they are drafted in very broad and open-ended terms to provide the ability to respond to changing markets. The result is a very one-sided contract, with the franchisor having the majority of discretionary power".[85] Further, one practitioner advised the Commission that he had "acted for numerous franchisors who started their franchise businesses in Manitoba, successfully sold 3 to 7 franchises and then collapsed, leaving their franchisees struggling on their own".[86]

[85] *Ibid.* at 2.

[86] Submission by A.L. Weinberg (July 18, 2007) at 1.

CHAPTER 3

CANADIAN FRANCHISE REGULATION

A. BACKGROUND

Governments in Canada, the U.S., and several other countries have taken legislative measures to regulate franchising activity. The early U.S. and Canadian statutes created franchisor registration schemes, modeled after U.S. securities legislation. These statutes required a franchisor to register documents relating to the sale and operation of a franchise with a governing body, and authorized the governing body to regulate and oversee franchise activity.

Recent Canadian statutes have adopted the disclosure model, which requires franchisors to disclose specific detailed information to prospective franchisees before the sale of a franchise, but does not include government registration or oversight. The legislation also includes provisions that govern to a degree the ongoing relationship between the parties, incorporating principles such as the duty to deal fairly and the right of the franchisee to associate freely with other franchisees.

B. CANADIAN FRANCHISE LEGISLATION

1. Alberta *Franchises Act*

Alberta was the first Canadian jurisdiction to enact franchise legislation, in 1971. The Alberta Act was modeled after the first U.S. franchise statute, in California,[1] which was in turn similar to California securities legislation. The 1971 Alberta Act was a registration statute that required prospective franchisors to register with the Alberta Securities Commission and to file certain documents, including a prospectus. The Act prohibited trading in a franchise without registration. Franchise salespersons were also required to register with the Commission.[2]

Under the 1971 Act, the Alberta Securities Commission carried out activities to oversee and regulate franchise activity, including reviewing prospectuses to determine compliance, investigating complaints and imposing sanctions for breaches of the Act. In addition, the Commission set policies that governed franchisor-franchisee conduct, covering matters such as standards for additional franchisor disclosure and for the termination of franchise agreements.[3] It has been suggested that in setting these policies, "the Agency's mandate [had], in some instances

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[1] Frank Zaid, *Canadian Franchise Guide*, looseleaf (Toronto: Carswell, 1993) at 2 - 101; Alberta Ministry of Consumer and Corporate Affairs, *Discussion Paper on the Alberta Securities Commission*, Part VII (1987), reprinted in Zaid, *Canadian Franchise Guide* at 2 – 113-114. California was the first U.S. state to enact franchise-specific legislation in 1970, with the *California Franchise Investment Law, California Corporations Code, Division 5, Parts 1-6*, §§31000-31516.

[2] *Franchises Act*, R.S.A. 1980, c. F-17 (repealed).

[3] Zaid, *Canadian Franchise Guide*, *supra* note 1 at 2 – 115-118M.

… been taken beyond the realm of administering and into the realm of franchise relationship legislating. … The policies also demonstrate the wide discretion which individual franchise analysts have to impose more or less onerous requirements in individual cases".[4]

By the late 1980s, concerns had arisen about the cost, administrative burden and delay associated with the registration and disclosure requirements.[5] The Alberta Securities Commission requested public comment on amendments to the Act in 1991, which was followed by the introduction of a Bill to replace the Act in 1992.[6] However, the 1992 Bill did not receive second reading. In 1995, following further public consultation and advice from a committee including representatives of the Canadian Franchise Association, the former Alberta Franchisors' Institute and the Franchisee Association of Alberta,[7] the Alberta Government replaced its regulatory structure with a new *Franchises Act* and regulations.[8]

The 1995 Act represented a significant departure in approach, and eliminated the filing requirements, Alberta Securities Commission oversight and the relationship standards enforced by Commission policy. The Act is a disclosure statute, and requires franchisors to provide a specified level of financial and other material fact disclosure to prospective franchisees, but does not require franchisor registration or document filing. The Act also includes provisions governing the franchise relationship, imposing a duty of fair dealing and protecting the freedom of franchisees to associate, and provides remedies for breaches of the legislation. As well, the Act includes provisions for self-government, which had been strongly supported by the Canadian Franchise Association[9] - the Lieutenant Governor in Council may designate one or more bodies to govern franchising and to promote fair dealing among franchisors and franchisees. However, a self-governing body has not been designated.

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[4] Zaid, *Canadian Franchise Guide*, *supra* note 1 at 2 - 118M.

[5] Alberta Ministry of Consumer and Corporate Affairs in Zaid, *Canadian Franchise Guide*, *supra* note 1 at 2 - 114. Typical registration costs for franchisors were reported to range between $10,000 and $20,000, and these costs, along with the inconvenience of registration, were thought to discourage potential franchisors from carrying on business in Alberta. The government also incurred costs in administering the Act.

[6] Frank Zaid, *Franchise Law* (Toronto: Irwin Law, 2005) at 25-26; Bill 45, *Franchises Act*, 4th Sess., 22nd Leg., Alberta, 1992-93. A Private Member's Bill to regulate franchising was also introduced in the Manitoba Legislature in 1992, by a member of the Opposition NDP party, Jim Maloway: Bill 18, *The Franchises Act*, 3rd Sess., 35th Leg., Manitoba, 1992. The Bill would have required franchisors to register a prospectus with the Manitoba Securities Commission, but was not enacted.

[7] Zaid, *Franchise Law*, *ibid.* at 26.

[8] *Franchises Act*, R.S.A. 2000, c. F-23 [*Alberta Act*]; *Franchises Regulation*, Alta. Reg. 240/95; *Exemption Regulation*, Alta. Reg. 249/95 (repealed). The 1995 *Exemption Regulation* was later replaced by the *Franchises Act Exemption Regulation*, Alta. Reg. 312/2000. Dillon notes that the 1995 Alberta Act closely resembles the *Model Franchise Investment Act* developed by the North American Securities Administrators Association, a body that addresses the harmonization of securities laws in North America: Peter M. Dillon, "Ontario's Franchise Regulatory Regime: Why Ontario Should Get Active in NASAA", *Siskinds Collection of Franchise Law Articles* (FRAN/RP-005, January 15, 2004) (QL).

[9] Zaid, *Canadian Franchise Guide*, *supra* note 1 at 2 - 118II.

2. Ontario *Arthur Wishart Act (Franchise Disclosure) 2000*

Ontario became the second Canadian jurisdiction to enact franchise legislation, the *Arthur Wishart Act (Franchise Disclosure) 2000*,[10] in 2000. The Act is named for the former Ontario Minister of Financial and Commercial Affairs, who established the first public inquiry into franchising in Canada in 1971. The resulting "Grange Report" had called for franchise legislation along the lines of the early Alberta Act, with a Franchise Bureau and Registrar.[11]

Franchising disputes were brought to public attention again in Ontario in the early 1990s, when media reports highlighted the litigation between the Pizza Pizza organization and a large number of its franchisees, who said that they were subjected to an arbitrary cost structure and "feudal-style" management.[12] In 1994, the Ontario Government announced the formation of a Franchise Sector Working Team, comprising representatives of franchisors, franchisees and government, to make recommendations on franchise regulation. The Team recommended that the Ontario Government enact legislation generally similar to the 1995 Alberta Act, although the franchisee representatives preferred to include additional provisions governing the franchise relationship. The Team recommended that alternate forms of resolving franchise disputes to litigation be explored and adopted, and that the Ontario Government carry out wide consultations and explore how national harmonized regulatory standards might be pursued.[13]

In 1998, the Ontario Government released a consultation paper on franchise legislation,[14] and in 1999, a Bill was introduced,[15] along with a Private Member's Bill dealing with franchising.[16] Several franchisees, franchisors and commentators made submissions at the public hearings that followed.[17] Among the heavily debated topics were the power imbalance between

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[10] *Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3 [*Ontario Act*].

[11] S.G.M. Grange, *Report of the Minister's Committee on Referral Sales, Multi-Level Sales and Franchises*, Ontario Ministry of Financial and Commercial Affairs (1971): see Zaid, *Canadian Franchise Guide*, *supra* note 1 at 2 – 123-126.

[12] *887574 Ontario Inc. v. Pizza Pizza Ltd*. (1995), 23 B.L.R (2d) 259 (Ont. Ct. Gen. Div.), leave to appeal refused [1995] O.J. No. 1645 (Ont. C.A.); *887574 Ontario Inc. v. Pizza Pizza Ltd*. (1994), 23 B.L.R. (2d) 239 (Ont. Ct. Gen. Div.); *887574 Ontario Inc. v. Pizza Pizza Ltd*. (1995), 23 B.L.R. (2d) 250 (Ont. Ct. Gen. Div.); John Lorinc, *Opportunity Knocks: The Truth About Canada's Franchise Industry* (Scarborough, Ont.: Prentice Hall Canada, 1995) at 169-205; C. French, "Disputes hurt franchising's image", *The Globe and Mail* (November 24, 1994) and Dillon, *supra* note 8 at 4.

[13] Ontario Franchise Sector Working Team, *Franchise Sector Working Team Report* (August 30, 1995) in Zaid, *Canadian Franchise Guide*, *supra* note 1 at 2 - 142J-142Z.4.

[14] Ontario Ministry of Consumer and Commercial Relations, *Ontario Franchise Disclosure Legislation* (Consultation Paper, June 1998), online: <http://web.archive.org/web/20000831070412/http://www.ccr.gov.on.ca/mccr/22c6_40a.htm>.

[15] Bill 33, *Arthur Wishart Act (Franchise Disclosure), 2000*, 37th Legislature, 1st Session, Ontario, 1999-2001, background material, online: http://www.ontla.on.ca/web/bills/bills_detail.do?locale=en&BillID=740&isCurrent=false&ParlSessionID=37%3A1.

[16] Bill 35, *Franchises Act*, 37th Legislature, 1st Session, Ontario, 1999-2001.

[17] Ontario, Legislative Assembly, Standing Committee on Regulations and Private Bills, *Official Report of Debates (Hansard: Hearing on Bill 33, Franchise Disclosure Act, 1999))* (March 7-9, 2000).

franchisors and franchisees, the restrictions placed on franchisees for the sourcing of products and services, the need for provisions for alternative dispute resolution, and the issue of good faith and fair dealing.[18]

The Ontario Act is a disclosure statute based largely on the 1995 Alberta Act, and similarly provides for a duty of fair dealing and the right to associate.[19] The Act does not provide for document registration or government oversight, and does not include an alternative dispute resolution mechanism.

3. Uniform Law Conference of Canada *Uniform Franchises Act*

The Uniform Law Conference of Canada (ULCC) had considered the issue of franchise regulation from time to time from the 1980s.[20] In June 2002, the ULCC established a working committee formed of franchise lawyers and industry and government representatives to develop uniform franchise legislation. The committee's work was a component of the Commercial Law Strategy, the aim of which was "to modernize and harmonize commercial law in Canada, with a view to creating a comprehensive framework of commercial statute law which will make it easier to do business in Canada, resulting in direct benefits to Canadians and the economy as a whole".[21]

After examination of the Alberta and Ontario Acts, the Draft Model Franchise Law adopted by the International Institute for the Unification of Private Law (UNIDROIT)[22] (discussed below) and the United States Federal Trade Commission Franchise Disclosure Rule[23] (discussed below), the committee reported to the ULCC[24] with a draft Model Bill and regulations in August 2005.

The Model Bill and regulations are based primarily on Ontario's *Wishart Act* and regulations. Provisions from the Alberta model were also adopted, along with a mediation process that is mandatory if a party to the franchise agreement initiates it. The committee

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[18] *Ibid.*; see also Daniel F. So, *Canadian Franchise Law Handbook* (Markham, Ont.: LexisNexis Butterworths, 2005) at 24-26.

[19] See also O. Reg. 581/00.

[20] Uniform Law Conference of Canada, *Commercial Law Strategy: Description of the Strategy*, online: <www.ulcc.ca/en/cls/index.cfm?sec=1>.

[21] *Ibid.* at 35.

[22] International Institute for the Unification of Private Law, *Model Franchise Disclosure Law* (September, 2002), online: <http://www.unidroit.org/english/modellaws/2002franchise/2002modellaw-e.pdf>.

[23] *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures*, Code of Federal Regulations, 16 C.F.R. § 436.

[24] Uniform Law Conference of Canada, Uniform Franchises Act Working Group, *Uniform Franchises Act Report of the Working Group* (August 2005), online: <http://www.chlc.ca/en/poam2/Uniform_Franchises_Act_Rep_En.pdf> [ULCC, *Uniform Franchises Act Report of the Working Group*]; see also Uniform Law Conference of Canada, *Proceedings of Annual Meetings, Civil Section* (August 10-14, 2003), online: <http://www.ulcc.ca/en/poam2/Civil-Minutes-2003-En.pdf>.

reported that

> many items currently contained in the Alberta or Ontario regulations have been substantially enhanced with additional disclosure requirements, definitions and more clarity in wording. In addition, new disclosure items have been included in the Regulations where it was considered appropriate, reasonable and necessary. In particular, the mediation Regulation is considered by the Committee to represent a significant and positive development in connection with the resolution of franchise disputes, in the interests [of] all stakeholders.[25]

In August 2005, the ULCC adopted the *Uniform Franchises Act* (the Model Bill)[26] and uniform regulations[27] and recommended them to the provinces and territories for enactment.[28]

4. Prince Edward Island *Franchises Act*

A group of Prince Edward Island franchisees, the Islanders for Fair Franchise Law, advocated for franchise legislation in P.E.I. in the 1990s. The group prepared a draft Bill, which was tabled in the Legislative Assembly in May 2001 and referred to the Standing Committee on Community Affairs and Economic Development.[29]

The Standing Committee reported to the House in November 2001.[30] The Committee recommended against the enactment of legislation based on the tabled Bill, but commented that "legitimate concerns were expressed to your Committee during the conduct of hearings that are worthy of further consideration".[31] The Committee recommended that the Office of the Attorney General prepare a draft Legislative Proposal using the Ontario and Alberta statutes as reference documents, but not limited to those models. The Committee suggested that the draft should require disclosure in sufficient detail to ensure that franchisees have enough information to make business decisions, and be "as consistent as possible with other Canadian jurisdictions to ensure that Franchisors are not confronted with a different set of rules in each province in which they wish to establish business".[32]

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[25] ULCC, *Uniform Franchises Act Report of the Working Group*, *ibid.* at 10.

[26] Uniform Law Conference of Canada, *Uniform Franchises Act*, online: <http://www.ulcc.ca/en/us/Uniform_Franchises_Act_En.pdf> [*ULCC Model Bill*].

[27] Uniform Law Conference of Canada, *Disclosure Documents Regulation*, online: <http://www.ulcc.ca/en/us/UFA_Disclosure_Documents_Reg_En.pdf>; Uniform Law Conference of Canada, *Mediation Regulation*, online: <http://www.ulcc.ca/en/us/UFA_Mediation_Reg_En.pdf>.

[28] Uniform Law Conference of Canada, *Report of the Commercial Law Strategy (*August 21-25, 2005), online: <http://www.ulcc.ca/enpoam2/index.cfm?sec=2005&sub=2005f >.

[29] Prince Edward Island, Legislative Assembly, *Hansard* (May 10, 2001) at 2044 and 2046.

[30] Prince Edward Island, Legislative Assembly, *Hansard* (November 29, 2001) at 328-329.

[31] *Ibid.*

[32] *Ibid*. at 329.

Prince Edward Island enacted the *Franchises Act*,[33] modeled primarily on the ULCC Model Bill, in June 2005. The province also released a Discussion Paper on draft franchise regulations in October 2005,[34] and made the *Franchises Act Regulations* in April 2006.[35] Several substantive provisions of the Act (for example, the duty to deal in good faith and the freedom of franchisees to associate) and part of the regulations came into force July 1, 2006, while the disclosure obligations and other provisions came into force on January 1, 2007.[36]

The P.E.I. Act and regulations closely follow the ULCC Model Bill, but the regulations differ in areas dealing with specific franchisor disclosure document requirements and exemptions.[37] According to the P.E.I. Government, this is because

> [t]he ULCC model regulations were developed on the assumption that there would be highly harmonized franchise law in place throughout the jurisdictions of Canada before the law would come into force. This is very different from the situation in which Prince Edward Island finds itself as it moves to bring into force its new legislation. In Canada, franchise law is only in force in two of the largest provinces, Alberta and Ontario. The draft PEI regulations take this into account.[38]

As a result, Prince Edward Island chose to follow the approach of the existing Alberta and Ontario Acts in some respects, or to incorporate new provisions, rather than to duplicate the Model Bill.

5. New Brunswick *Franchises Act*

The New Brunswick Government introduced Bill 6, the *Franchises Act*,[39] in December 2005, following the earlier introduction of a Private Member's Bill in June 2005.[40] Bill 6 died on the Order Paper when the Legislature dissolved in 2006.

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[33] *Franchises Act*, R.S.P.E.I. 1988, F-14.1 [*P.E.I. Act*].

[34] P.E.I. Office of the Attorney General, *Franchises Act Regulations Discussion Paper* (October 19, 2005), online: <http://www.gov.pe.ca/photos/original/oag_franchiseac.pdf>.

[35] *Franchises Act Regulations*, P.E.I. Reg. EC232/06 [*P.E.I. Regulations*].

[36] *Prince Edward Island Royal Gazette* Vol. CXXXII – No. 18 (May 6, 2006) at 409 and Part II - 140, online: <http://www.gov.pe.ca/royalgazette/pdf/20060506.pdf>; Frank Zaid and Dominic Mochrie, "P.E.I. and New Brunswick On Board With Franchise-Specific Legislation" (July 7, 2006), online: Osler, Hoskin & Harcourt LLP <http://www.osler.com/resources.aspx?id=11154>.

[37] For example, the P.E.I. regulations allow a franchisor to use a disclosure document that meets the requirements of another jurisdiction, if a "wrap-around" document is attached to include any additional material necessary in P.E.I. The regulations also exempt large franchisors from the requirement to provide financial statements, provide that there is no right of rescission if a disclosure document is substantially complete, allow disclosure documents to be delivered electronically and limit the disclosure of current and former franchisee information to regional franchises: *P.E.I. Regulations*, *supra* note 35.

[38] P.E.I. Office of the Attorney General, *supra* note 34 at 1.

[39] Bill 6, *Franchises Act*, 3rd Sess., 55th Leg., 2005-2006.

[40] Bill 81, *Franchise Act*, 2nd Sess., 55th Leg., 2nd Session, New Brunswick, 2004-2005.

In a press release on December 7, 2005, the Minister of Justice said:

> This bill will ensure fairness in the relationship between small business people in New Brunswick and franchisors, while protecting our province's competitive position in attracting new business investment.[41]

Bill 32, the *Franchises Act*,[42] was introduced in the New Brunswick Legislative Assembly on February 23, 2007 and received Royal Assent on June 26, 2007. The Act is not yet in force and regulations have not been made. Like the former Bill 6, the New Brunswick Act is a disclosure statute based closely on the ULCC Model Bill, and similarly includes a mediation process that is mandatory if initiated by one of the parties to a franchise agreement.

C. AGREEMENT ON INTERNAL TRADE

Canada's *Agreement on Internal Trade* came into force on July 1, 1995.[43] The Agreement was signed by all provinces and territories and the federal government, with the purpose of reducing and eliminating, to the extent possible, barriers to the free movement of persons, goods, services, and investment within Canada and to establish an open, efficient, and stable domestic market.[44]

The parties agreed to six general rules, including ensuring that government policies and practices do not create obstacles to trade, ensuring that non-trade objectives that may cause some deviation from the guidelines have a minimal adverse impact on interprovincial trade, and eliminating trade barriers caused by differences in standards and regulations across Canada. As one measure, governments are to focus on reconciling their consumer protection requirements that act as non-tariff barriers to allow Canadian firms to capitalize on economies of scale by servicing larger markets.[45]

D. ELEMENTS OF CANADIAN FRANCHISE LEGISLATION

As noted, the existing Canadian franchise statutes require franchisors to disclose specific detailed information to prospective franchisees before the sale of a franchise. The legislation also governs the relationship between a franchisor and franchisee to a limited extent, imposing a duty on the parties to a franchise agreement to deal fairly and protecting the right of franchisees

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[41] Hon. B. Green, New Brunswick Minister of Justice, *Press Release* (December 7, 2005), quoted in J. Scott MacKenzie and Michael D. Wennberg, "Franchise Law: Prince Edward Island and New Brunswick Updates", 7:1 *Atlantic Business Counsel* (January, 2006), online: Stewart Mckelvey Stirling Scales <http://www.smss.com/site-smss/media/Parent/atlanticbusinesscounsel.pdf>.

[42] S.N.B. 2007, c. F-23.5 [*New Brunswick Act*].

[43] *Agreement on Internal Trade*, September 1994, online: <http://www.ait-aci.ca/index_en/ait.htm>.

[44] Internal Trade Secretariat, *Overview of the Agreement on Internal Trade*, online: <http://www.ait-aci.ca/index_en/ait.htm>.

[45] *Ibid*.

to associate with other franchisees. No Canadian statutes provide for government registration or oversight.

This section provides a brief summary of the elements of Canadian franchise legislation; the elements are discussed in greater detail in Chapter 5.

The Canadian franchise statutes contain the following elements:[46]

1. Franchisors are required to provide written pre-sale disclosure of specified items, including financial statements, the background of the franchisor and other information, at least 14 days before the franchisee signs a franchise agreement or pays money toward the franchise;
2. In addition to the specified disclosure categories, franchisors must disclose all material facts that would reasonably be expected to have a significant effect on the value or price of the franchise or the decision to acquire the franchise;
3. The franchisor must also provide written statements of any material changes that occur after the disclosure document is provided and before the franchise agreement is signed or money is paid;
4. The franchisee has the right to rescind the franchise agreement within 60 days if the franchisor fails to provide the disclosure document within the time required or if the contents of the disclosure document do not meet the statutory requirements;
5. Where the franchisor provides no disclosure document, the franchisee may rescind the franchise agreement within two years;
6. Upon rescission, the franchisor must refund any money received from the franchisee, buy back any remaining supplies, equipment and inventory sold to the franchisee and compensate the franchisee for any net losses that the franchisee has incurred;
7. The franchisee has a right of action for damages if the franchisee suffers a loss because of a misrepresentation in the disclosure document or statement of material change or because of the franchisor's failure to comply with the disclosure requirements;
8. Each party to a franchise agreement is subject to the duty of fair dealing, which includes the duty to act in good faith and in accordance with reasonable commercial standards;
9. A party has a right of action for damages against another party who breaches the duty of fair dealing;
10. A franchisee has the right to associate with other franchisees and to form or join an organization of franchisees;
11. A franchisee has a right of action for damages against a franchisor that interferes with the right to associate;
12. Parties to a franchise agreement who are found to be liable in an action under the Act are

[46] There are some variations among the statutes; these are outlined in Chapter 5.

jointly and severally liable;[47]

13. A waiver or release by a franchisee of a statutory right or requirement is void;
14. A provision that purports to restrict the application of the law of the province or to restrict jurisdiction or venue to a forum outside the province is void;
15. The burden of proving an exemption from a provision of the Act is on the person claiming it.

The ULCC Model Bill and the New Brunswick Act also provide for a mediation process that is mandatory once initiated by a party to the franchise agreement. As well, under the provincial statutes, regulations may be made to provide for certain exemptions from requirements of the Act or regulations.

[47] The Acts vary in this respect: the Alberta Act refers to "an action under this Act", while the ULCC Model Bill and the other provincial Acts refer to actions in relation to the duty of fair dealing, the right of franchisees to associate and the disclosure requirements: *Alberta Act*, *supra* note 8, s. 12; *Ontario Act*, *supra* note 10, s. 8; *ULCC Model Bill*, *supra* note 26, s. 9; *P.E.I. Act*, *supra* note 33, s. 9; *New Brunswick Act*, *supra* note 42, s. 9.

CHAPTER 4

INTERNATIONAL FRANCHISE REGULATION

A. UNITED STATES

1. FTC Franchise Disclosure Rule and UFOC Guidelines

Franchising in the United States is regulated by the federal government and by several state governments.[1] Federally, franchise sales are regulated by the Federal Trade Commission Franchise Disclosure Rule, made under the *Federal Trade Commission Act*.[2] Under the FTC Rule:

> a franchise exists in a commercial arrangement between a buyer and seller when the following three elements are present: (i) a grant of the right to use the seller's trademark to offer, sell or distribute goods or services; (ii) the seller offers significant assistance to the buyer in its operations or reserves the right to control its operations; and (iii) the payment of a fee ($500 or more within the first six months of operations). The FTC Rule is interpreted liberally to further its primary goal of investor protection.[3]

The FTC Rule requires franchisors to make detailed disclosures to prospective franchisees. The Rule deals only with franchisor disclosure; there is no express duty of good faith or fair dealing and franchise relationship issues are governed by state contract law.[4] There is no filing or registration requirement and the FTC does not review disclosures.

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[1] As of 2002, fifteen state governments required pre-sale disclosure of franchise information: U.S. Federal Trade Commission, *The Franchise Rule* (Statement before the U.S. House of Representatives, Committee on Energy and Commerce, Subcommittee on Commerce, Trade and Consumer Protection, June 25, 2002), online: <http://www.ftc.gov/os/2002/06/020625bealesfranruletest.htm>.

[2] *Federal Trade Commission Act*, 15 U.S.C. §§ 41-58 [*FTC Act*]; *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures*, 16 C.F.R. § 436 [*FTC Franchise Rule*]. See also U.S. Federal Trade Commission, *Guide to the FTC Franchise Rule Table of Contents*, online: <http://www.ftc.gov/bcp/franchise/netrule.shtm>.

[3] L. Seth Stadfeld, *Basic Franchise Law Considerations in Supply Relationships*, online: Weston, Patrick, Willard & Redding, PA, Boston, MA <http://www.franchise-counsel.com/Relationships.shtml> [Stadfeld, *Franchise Law Considerations*]; see *FTC Franchise Rule*, *ibid*., 16 C.F.R. § 436.2. State law definitions are similar to the FTC definition, except that instead of the "assistance and control" element, they require a marketing plan prescribed substantially by the franchisor or a community of interest between the parties with respect to the business.

[4] U.S. Federal Trade Commission, *The Franchise Rule*, *supra* note 1. The FTC stated that while franchisee advocates have asserted that "the underlying relationship between franchisor and franchisee is often unfair, with the franchisor dictating the terms under which the franchisee will conduct business, often allegedly resulting in significant financial losses", the FTC has not received a large number of complaints about relationship issues and it was "unaware of any evidence that relationship issues are prevalent throughout franchising", at Part III. Although the FTC Franchise Rule does not govern relationship issues, the FTC does enforce section 5 of the *Federal Trade Commission Act*, which declares unlawful unfair or deceptive practices in or affecting commerce, when specific criteria are met: *FTC Act*, *supra* note 2. However, the FTC's unfairness authority is limited by its governing legislation, and the specific criteria required generally are not met in the context of franchise relationships. See also U.S. General Accounting Office, *Federal Trade Commission: Enforcement of the Franchise Rule* (Report to Congressional Requesters, July 2001) at 7-9 and 40-45, online: <http://www.gao.gov/new.items/d01776.pdf>.

There is no private right of action to enforce the Rule; only the FTC can enforce it.[5] The FTC has a broad range of remedies that it may seek for violations, including injunctions, civil penalties and orders for the refund of money to franchise purchasers.

The FTC Rule

> requires franchisors to make material disclosures in five categories: (1) the nature of the franchisor and the franchise system; (2) the franchisor's financial viability; (3) the costs involved in purchasing and operating a franchised outlet; (4) the terms and conditions that govern the franchise relationship; and (5) the names and addresses of current franchisees who can share their experiences within the franchise system, thus helping the prospective franchisee to verify independently the franchisor's claims. In addition, franchisors must have a reasonable basis and substantiation for any earnings claims made to prospective franchisees, as well as disclose the basis and assumptions underlying any such earnings claims.[6]

Several states have franchisor registration requirements modeled after securities legislation; franchisors must register with a state regulatory agency and obtain approval before they can offer their franchises to prospective franchisees.[7] Unlike the FTC Rule, state laws provide a private right of action to franchisees. As well, several states have enacted franchise relationship legislation to govern the relationship between the parties after the franchise agreement is signed. All of these statutes have provisions governing termination of the franchise agreement; other matters include contract renewal and transfer, territory encroachment, the purchase of goods and services from designated sources of supply, franchisees' right to associate and forum selection.[8]

The FTC Rule and state laws require the franchisor to provide the disclosure document at least ten business days before the franchisee pays any consideration or signs a contract. A copy of the franchise agreement with all terms completed and all related agreements must be delivered at least five business days before signing.

Currently, most U.S. franchisors use a uniform disclosure format called the Uniform Franchise Offering Circular, or UFOC, produced by the North American Securities

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[5] U.S. Federal Trade Commission, *The Franchise Rule*, *supra* note 1; U.S. Federal Trade Commission, *Guide to the FTC Franchise Rule Table of Contents*, *supra* note 2.

[6] U.S. Federal Trade Commission, *The Franchise Rule*, *ibid.* at Part IA.

[7] Stadfield, *Franchise Law Considerations*, *supra* note 3. There are additional state laws that may apply; for example, state "business opportunity" statutes designed to encompass distribution arrangements accompanied by representations or promises, such as vending machine routes.

[8] U.S. General Accounting Office, *supra* note 4 at 9 and 43-45. The GAO identified 17 states that have enacted franchise relationship legislation; Iowa's is recognized as being the most comprehensive. As well, two federal statutes regulate franchise relationships in the automobile and petroleum industries, addressing termination and non-renewal of the franchise agreement: *Automobile Dealers Day in Court Act*, 15 U.S.C. §§ 1221-1225; *Petroleum Marketing Practices Act*, 15 U.S.C. §§ 2801-2806.

Administrators Association (NASAA).[9] The UFOC has been accepted by the FTC and by state regulators.[10] The UFOC and the FTC Rule require similar disclosures, including a description of: (1) the franchisor and its business; (2) prior litigation and bankruptcies relating to the franchisor; (3) initial and ongoing fees; (4) obligations of the parties and other terms of the contract; (5) restrictions on sales; and (6) rights to renew and terminate the franchise. Both formats also require substantiation of any earnings claims, statistics on existing franchisees, contact information for franchisees, and audited financial statements.[11]

The UFOC Guidelines also contain disclosure provisions in addition to those required under the FTC Rule, including information about regulations specific to the franchise industry, litigation or bankruptcy involving a franchisor's predecessor, computer system requirements and contact information for former franchisees.[12] As well, under amendments made in 1993, the disclosure must be written in "plain English". In many states, the UFOC includes an addendum to set out the specific requirements of that state.[13]

Under the FTC Rule and the UFOC Guidelines, a franchisor must comply with certain requirements if it makes an earnings claim. For example, under the UFOC, the claim must have a "reasonable basis" and include the factual basis for the claim (such as economic and market conditions, costs of goods sold and operating expenses), state the material assumptions underlying the claim and the precise basis for it (for example, the percentage of franchisees that has achieved it), include a conspicuous statement that a franchisee's results are likely to differ and offer to provide substantiation upon request.

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[9] North American Securities Administrators Association [NASAA], *Uniform Franchise Offering Circular Guidelines*, online: <http://www.nasaa.org/Industry___Regulatory_Resources/Uniform_Forms/3697.cfm>.
According to Stadfeld, "the states refused to follow the FTC's disclosure format largely because they sought more comprehensive regulation… these states promulgated a more rigorous disclosure format" – the UFOC: L. Seth Stadfeld, *Federal Franchise Sales Law Updated for First Time Since 1978*, online: Weston, Patrick, Willard & Redding, PA, Boston, MA <http://www.franchise-counsel.com/New-FTCLaw.shtml> [Stadfeld, *Franchise Sales Law Updated*].

[10] The FTC authorized franchisors to use the UFOC Guidelines to comply with the FTC Rule's disclosure requirements because the Guidelines, in their entirety, provided consumer protection equal to or greater than the Rule: U.S. Federal Trade Commission, *16 CFR Parts 436 and 437: Disclosure Requirements and Prohibitions Concerning Franchising; Disclosure Requirements and Prohibitions Concerning Business Opportunities; Final Rule* (2007) at 15449, n. 46, online: <http://www.ftc.gov/os/2007/01/R511003FranchiseRuleFRNotice.pdf> [U.S. Federal Trade Commission, *Final Rule*].

[11] U.S. Federal Trade Commission, *The Franchise Rule*, *supra* note 1. The FTC Format is not accepted by state regulators in states with registration requirements: Stadfield, *Franchise Law Considerations*, *supra* note 3.

[12] U.S. Federal Trade Commission, *The Franchise Rule*, *ibid.* at n. 9.

[13] Richard D. Leblanc and Peter M. Dillon, "Franchise Disclosure in Canada in 2007 and Beyond" (Paper presented to The Domino Effect: 6th Annual Franchising Conference, Ontario Bar Association, November 16, 2006).

2. FTC Rule Amendments

Beginning on July 1, 2008, the requirements of U.S. franchisors under the FTC Rule will change significantly. Following a lengthy review and consultation process,[14] the FTC has substantially revised and modernized the Franchise Rule.[15] Compliance with the new Rule was voluntary as of July 1, 2007 and will be mandatory on July 1, 2008. Permission to use the UFOC Guidelines will be withdrawn effective July 1, 2008,[16] and franchisors will be required to use the new FTC Franchise Disclosure Document, which adopts the UFOC format (and plain English requirement) but supplements it with additional disclosure requirements.[17]

New disclosure requirements under the revised FTC Rule include:

- a summary of all material litigation relating to the franchise relationship commenced by a franchisor, its predecessors and certain affiliates against franchisees during the preceding year (currently only litigation by franchisees must be disclosed);
- identification of any individual who will exercise management responsibility relating to the franchise;
- a summary of all government litigation against a franchisor affiliate that sold franchises within the previous 10 years;
- a statement as to whether any officer of the franchisor has an interest in any required supplier;
- information as to how the franchisor or an affiliate may compete with franchisees through distribution channels such as the internet, catalogue sales, telemarketing, co-branding or the establishment of units at "nontraditional locations";
- expanded disclosure with respect to franchisee territories, including the conditions under which a franchisor will approve franchisee relocation and the establishment of additional outlets, any present plans of the franchisor to operate a competing franchise system, the limits on franchisee solicitations outside assigned territories and a warning of possible adverse consequences if the franchisee will not have exclusive territorial rights;
- an explanation of the franchisor's renewal policies, including any obligation to sign a new franchise agreement on different terms at renewal;

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[14] See Lane Fisher, "FTC Rule Change: The Question Of When" *FranchiseLawNews.Com* (November 2005), online: <http://www.franchiselawnews.com/article/2005/11/08/1/>.

[15] The FTC has released the revised Rule and a Statement of Business and Purpose that provides a rationale for and an explanation of the changes. The new Rule separates the requirements relating to franchises from those relating to business opportunities, and the FTC has initiated a separate review process for the business opportunity requirements: U.S. Federal Trade Commission, *Final Rule*, *supra* note 10 at 15444. For a detailed explanation of the changes, see also U.S. Federal Trade Commission, *Franchise Rule 16 C.F.R. Part 436: Compliance Guide* (May 2008), online: <http://www.ftc.gov/bcp/franchise/franchise-rule-compliance-guide.pdf> [U.S. Federal Trade Commission, *Compliance Guide*].

[16] This is because the UFOC Guidelines will no longer provide equal or greater protection to prospective franchisees: U.S. Federal Trade Commission, *Final Rule*, *ibid*. at 15448, n. 46.

[17] David J. Kaufmann, "It's official: FTC revamps federal Franchise Rule" *Franchise Times* (March 2007), online: <http://www.franchisetimes.com/content/story.php?article=00256>. The new Rule is narrower than the existing UFOC Guidelines in some respects. For example, it eliminates some disclosures relating to brokers and to detailed computer equipment requirements: U.S. Federal Trade Commission, *Final Rule*, *ibid*. at 15444.

- a statement that franchisors are permitted to make financial performance representations in the disclosure document, and, if none appears in the document, franchisees should disregard other representations and report them to government agencies;
- information as to whether a franchise unit has been the subject of repeated sales to different franchisees;
- contact information for each affiliated trademark-specific franchisee association; and
- information as to whether any current or former franchisees are restricted from speaking freely due to a confidentiality agreement.[18]

The Rule also allows franchisors to disclose exclusively in electronic form, and franchisee receipts may be executed and returned electronically.[19] Franchisors must update the disclosure documents annually, or quarterly if there is a material change in the information. There is a continuing update requirement for material changes to financial performance representations; the franchisor must notify a prospective franchisee of the change before the prospective franchisee pays a fee or signs the franchise agreement.[20]

Franchisors will be able to provide stand-alone franchise cost or operating expense information even if no financial performance representations are included in the disclosure document, with a warning that this information does not constitute a financial performance representation. Start-up franchisors may phase in audited financial statements over a three year period. The Rule also includes new "sophisticated investor" exemptions from disclosure where prospective franchisees meet certain net worth, investment or experience criteria.[21]

The new FTC Rule does not incorporate new provisions to govern the franchise relationship. This was an area of significant concern raised with the FTC during the review process:

> [M]any franchisees and their advocates criticized the Rule for not going far enough. They urged the Commission to address in this rulemaking a variety of post-sale franchise contract or "relationship" issues, including prohibiting or limiting the use of post-contract covenants not to compete, encroachment of franchisees' market territory, and restrictions on the sources of products or services. Indeed, some franchisees asserted that if the Rule cannot address post-sale relationship issues, then the Commission should abolish the Rule.[22]

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[18] U.S. Federal Trade Commission, *Final Rule*, *ibid.*; Kaufmann, *ibid.*; Stadfeld, *Franchise Sales Law Updated*, *supra* note 9; Anthony Marks and Keith Klein, "FTC Franchise Rule 2.0" (Spring 2007) 14:1 *Consumer Protection Update* 22, online: <http://www.bryancave.com/anthonymarks/>.

[19] U.S. Federal Trade Commission, *Compliance Guide*, *supra* note 15 at 126-129; U.S. Federal Trade Commission, *Final Rule*, *supra* note 10 at 15467.

[20] U.S. Federal Trade Commission, *Final Rule*, *supra* note 10 at 15518-15520.

[21] U.S. Federal Trade Commission, *Final Rule*, *supra* note 10; U.S. Federal Trade Commission, *Compliance Guide*, *supra* note 15.

[22] U.S. Federal Trade Commission, *Final Rule*, *ibid.* at 15447. See Susan P. Kezios, President, American Franchisee Association, Letter to the Federal Trade Commission (April 30, 1997), online: <http://www.ftc.gov/bcp/franchise/comments/kezios62.htm>.

However, the FTC notes that its ability to address relationship issues is restricted by the terms of its governing legislation:

> The FTC Act defines an unfair act or practice as one that is "likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition." The Act also requires that, to justify an industry-wide rule, such practice be prevalent. This proceeding did not yield adequate evidence to support a finding of prevalent acts or practices that meet each of the three prerequisites for unfairness as articulated in Section 45(n) of the FTC Act.[23]

According to the FTC, while it received evidence of injury to franchisees that may be ascribable to acts of franchisors, it is an open question whether the practices are prevalent and the injuries substantial when viewed from the standpoint of the franchising industry as a whole, rather than of a single franchise system. As well, since the purchase of a franchise is voluntary, the FTC could not conclude that prospective franchisees who receive full disclosure could not reasonably avoid the harm. Finally, advocates asserting injury to franchisees did not provide evidence that the injury outweighs potential countervailing benefits to the public at large or to competition. As a result, the FTC declined to impose provisions governing the substantive terms of franchise contracts that would apply to the entire franchise industry.[24] On the other hand, as noted above, the FTC did include additional disclosure provisions, concluding that more disclosure was "warranted to ensure that prospective franchisees are not deceived about the quality of the franchise relationship"[25] before they commit to a franchise.

B. AUSTRALIA

Australia has a substantial franchising sector relative to its population, with a total of 70,250 franchise units in 2006 and a growth rate from 2004 to 2006 of approximately 15%.[26] The total sales turnover of the business format franchise sector in 2005 was estimated at $128 billion, or 14% of Australia's gross domestic product.[27]

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[23] U.S. Federal Trade Commission, *Final Rule*, *supra* note 10 at 15447.

[24] *Ibid*. at 15447-15448. The FTC also noted that it has previously voiced concerns with respect to government-mandated contractual terms, stating that terms that are driven by market forces and private parties acting in their own self-interest are most likely to result in products reaching market quickly and efficiently. The FTC has authorized its staff to file advocacy comments in relation to state bills that would limit manufacturers' ability to manage their distribution systems by requiring exclusive territories, burdening wholesaler terminations or limiting responses to changing competitive conditions: at 15448, n. 45.

[25] *Ibid*. at 15448.

[26] Lorelle Frazer, Scott Weaven and Owen Wright, *Franchising Australia 2006* (Brisbane: Griffith University Service Industry Research Centre, 2006) at 9, online: <http://www.franchise.org.au/content/?action=getfile&id =450>. This figure includes 5,660 company owned units and 8,390 fuel and motor vehicle retail outlets; the growth rate also includes company owned units.

[27] *Ibid*.

The Australian Government's first intervention in the franchising field was a voluntary Franchising Code of Practice, developed in 1993.[28] The Code set standards of franchisor disclosure, implemented franchisee cooling-off periods and provided access to dispute resolution mechanisms. However, a 1995 review found that only about 50% to 60% of franchisors had chosen to register.[29] The Code was widely viewed to be ineffective, and was allowed to lapse.[30]

In 1998, regulations implementing a mandatory Franchising Code of Conduct[31] were made under the *Trade Practices Act 1974*.[32] The key features of the Code are the requirement that franchisors provide the appropriate disclosure document and a copy of the Code at least 14 days before an agreement is signed or a non-refundable payment is made, a cooling-off period (a franchisee may terminate an agreement within 7 days of signing it or of making a payment), mandatory mediation for dispute resolution and mandatory disclosure of information by a vendor franchisee to a prospective purchaser of the franchisee's business. A franchisor must provide a new disclosure document to franchisees every year upon request. As well, a franchisor must not enter into, renew or extend a franchise agreement or receive a non-refundable payment unless the franchisee has provided a written statement that the franchisee has received, read and had a reasonable opportunity to understand the disclosure document.[33]

In the case of a new franchise agreement, the franchisor must also receive signed statements from the franchisee that the franchisee has been given advice by an independent legal or business advisor or an accountant or has been told that that kind of advice should be sought but has decided not to seek it. A franchisor may not induce a franchisee not to associate with other franchisees, and franchise agreement must not contain a general release of the franchisor from liability. A franchisor must give a franchisee a reasonable time to remedy a breach (up to 30 days) before it can terminate an agreement, and franchise agreements must provide for a dispute mediation procedure that complies with the Code.[34]

Apart from the dispute resolution process, a party to a franchise agreement must seek compensation for damages through litigation. However, the Code is a mandatory industry code under the *Trade Practices Act, 1974*, and the Australian Competition and Consumer Commission (ACCC) also carries out a role in educating the public about the Code, and in investigating and bringing proceedings against those suspected of breaching the Code. The Commission can also

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[28] Austl., Commonwealth, Office of Small Business, *Review of the Franchising Code of Conduct: Discussion Paper* (Canberra: Office of Small Business, December 1999).

[29] *Ibid.* Key franchising sectors, including the motor vehicle and real estate franchise industries, chose not to be covered by the Code, and non-compliance with the Code was an issue even among those franchisors who had registered.

[30] *Ibid.*

[31] *Trade Practices (Industry Codes – Franchising) Regulations 1998* (Cth.) [*Franchising Code of Conduct*].

[32] *Trade Practices Act 1974* (Cth.).

[33] *Franchising Code of Conduct, supra* note 31.

[34] *Ibid.*

apply for injunctions and for compensatory orders on behalf of individuals who have suffered loss as a consequence of another person's breach.[35]

The Franchising Policy Council conducted a review of the 1998 Code in 2000. The Council made a number of recommendations for amendments, but concluded that overall, the Code had been a successful initiative and that the benefits to the industry outweigh the costs of compliance with the Code.[36]

In 2006, a survey of franchising in Australia found that the most common causes of franchisor-franchisee disputes were related to system compliance, communication problems and claims of misrepresentation. Mediation was used as a means of resolving disputes more than twice as often as litigation.[37]

The Franchising Code of Conduct was again reviewed in 2006 by the Franchising Code Review Committee, established by the Australian Government following concerns raised about whether the disclosure provisions of the Code were working effectively and about the enforcement of the Code by the ACCC.[38] The Committee made a number of recommendations, including the following:

- the franchisor should be required to provide all agreements, in the form in which they are intended to be executed, at the same time as the disclosure document. The Committee had found that franchisees were in some cases given complete contracts only at the time of signing, and that the contracts presented for signing sometimes differed from earlier drafts;
- financial disclosure requirements should be extended to any consolidated entity to which the franchisor belongs;

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[35] Austl., Commonwealth, Franchising Code Review Committee, *Review of the Disclosure Provisions of the Franchising Code of Conduct*: *Report to the Hon Fran Bailey, Minister for Small Business and Tourism* (Canberra: Secretariat, Office of Small Business, October 2006) at 26-27, online: <http://www.innovation.gov.au/Section/SmallBusiness/Documents/Franchising_Code_Review_Report_2006_FINAL_06120720070205134250.pdf> [Franchising Code Review Committee]; franchisees may also have remedies at common law (at 29). See also John Martin, Commissioner, Australian Competition and Consumer Commission, *The Health of Franchising from the Viewpoint of its Regulator* (Paper for the Franchise Council of Australia Adelaide Conference, October 23, 2001), online: <http://www.accc.gov.au/content/index.phtml/itemId/179406>.

[36] Austl., Commonwealth, Franchising Policy Council, *Review of the Franchising Code of Conduct: Report of the Franchising Policy Council* (Canberra: Secretariat, Office of Small Business, May 2000). These included a recommendation that a short form disclosure document be used for franchises with an annual turnover of less than $50,000 annually, that international franchisors be exempt from the disclosure requirements where an Australian master franchisor has been appointed to make the disclosures, and that the Government consider expanding the functions of the ACCC to enable the Commission to more closely monitor compliance with the Code. The Council noted options such as requiring disclosure documents to be registered with the ACCC. The regulations were amended in 2001 to implement the short form disclosure document for small franchises, to clarify that both a franchisor and master franchisee must disclose information to a sub franchisee (a joint form is permitted) and to require franchisors to maintain current disclosure documents: *Trade Practices (Industry Codes – Franchising) Amendment Regulations 2001 (No. 1)* (Cth.).

[37] Frazer, Weaven and Wright, *supra* note 26 at 11.

[38] Franchising Code Review Committee, *supra* note 35 at 22.

- the franchisor should be required to provide a risk statement identifying known significant risks that could have a material impact on the franchise;
- marketing fund annual financial statements should be required to be audited;
- the requirement to disclose financial benefits received by the franchisor or an associate of the franchisor from the supply of goods or services to franchisees should include the amount or method of calculation of the rebate or benefit;
- the ACCC should collect information respecting the auditing of financial statements and determine whether the lack of audited statements is causing unsatisfactory outcomes;
- where consent is obtained, the contact details of past franchisees should be included in the disclosure document (along with the number of past franchisees who declined to give consent);
- the business experience of all who take part in the management of the franchisor should be disclosed;
- franchisor disclosure should be extended to franchisor directors in respect of criminal or civil judgments or proceedings, public agency proceedings or arbitration awards relating to a breach of a franchise agreement, trade practices law or corporations law, or to unconscionable conduct, misconduct or dishonesty. The scope of disclosure should be extended to criminal convictions for non-serious offences;
- the exemption for international franchisors with only one franchise or master franchise in Australia should be deleted;
- consideration should be given to prohibiting unilateral material changes by franchisors and removing or modifying the right of a franchisor to unilaterally terminate a franchise agreement. If the right is maintained, adequate franchisee compensation should be required;
- franchisors should be prohibited from inducing prospective franchisees not to associate or communicate with current or past franchisees (the current prohibition applies to current franchisees associating with other franchisees);
- franchisors should be required to register with and submit annual disclosure documents to the ACCC and the ACCC should undertake sample audits of disclosure documents;
- the Government should apprise the ACCC of franchisee concerns respecting the level of enforcement action;
- the Code should include a requirement of good faith and fair dealing.[39]

The Australian Government announced in February 2007 that it accepted most of the recommendations of the Review Committee, and would consult with the franchising industry on their implementation. The Government declined to implement the recommendations for a duty of good faith, mandatory risk statements, mandatory franchisor registration, the collection of information by the ACCC respecting the auditing of financial statements and ACCC disclosure

[39] Franchising Code Review Committee, *supra* note 35.

document audits.[40] The recommendation respecting the right of franchisors to unilaterally terminate or change franchise agreements was addressed through amendments to the *Trade Practices Act 1974*;[41] the fact that a corporation has a contractual right to unilaterally vary a term of a contract was added as a factor that a court may consider when determining whether the corporation has engaged in unconscionable conduct.

Regulations to amend the Franchising Code of Conduct[42] came into force on March 1, 2008. Among other things, the amendments require franchisors to provide details of the franchise site or territory and a copy of the franchise agreement in its final form to prospective franchisees at the same time as the disclosure document. Franchisors must also provide associated documents, such as leases and guarantees, at least 14 days before the franchise agreement is signed, if they are available at that time. Financial information respecting a consolidated entity to which a franchisor belongs must be provided upon request.

In addition to providing the number of former franchisees who exited the system during the previous three years, the name, location and contact details of each must be provided unless the franchisee has requested in writing that the details not be disclosed. Where the franchisor or an associate receives a rebate or other financial benefit from the supply of goods or services to franchisees, franchisors must now provide the name of the business providing the rebate or benefit and note whether any rebate or benefit is shared directly or indirectly with franchisees. The amount or method of calculation of the benefit is not required. As well, the prohibition on preventing franchisees from associating with each other is extended to prospective franchisees.

Disclosure requirements will now extend to the qualifications and business experience of "officers" of the franchisor, rather than to the directors, secretaries, executive officers and partners who hold management responsibilities. The definition of "officer"[43] lists persons holding a broad range of positions, and includes a person who participates in making decisions that affect a substantial part of the business of a corporation. Disclosure must also be made by the directors of a franchisor as well as by the franchisor with respect to proceedings or judgments relating to a breach of a franchise agreement, misconduct and other matters. The contents of orders made or undertakings given under the *Trade Practices Act 1974* (rather than just the dates) must be disclosed in the disclosure document, or within 14 days after the order is made or the undertaking given. The amendments also remove the exception from the Code for foreign franchisors who have granted only one franchise or master franchise for operation in Australia.

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[40] Fran Bailey, Commonwealth (Austl.), Minister of Industry, Tourism and Resources, *Reform of Franchising Code of Conduct*, Media Release (February 6, 2007); Fran Bailey, Commonwealth (Austl.), Minister of Industry, Tourism and Resources, *Consultation with the Franchising Industry Underway*, Media Release (February 21, 2007); Austl., Commonwealth, *Australian Government Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct* (February 2007), online: <www.innovation.gov.au/Section/SmallBusiness/Documents/Response_to_Recommendations_(Final)06Feb0720070206091019.pdf.

[41] *Trade Practices Act 1974* (Cth.), s. 51AC(3)(ja); s. 51AC(3)(k) also includes "good faith" as a factor that can be taken into account when determining whether a party has engaged in unconscionable conduct.

[42] *Trade Practices (Industry Codes – Franchising) Amendment Regulations 2007 (No. 1)* (Cth.).

[43] *Corporations Act 2001* (Cth.), s. 9.

The amendments do not affect the ability of a franchisor to include a right of unilateral termination in a franchise agreement and do not require that a franchisor pay compensation on termination.

C. EUROPE

The most important European Union law affecting franchising is Article 81 of the European Community Treaty.[44] It prohibits agreements distorting competition and a number of practices that may be found in franchising, such as the sharing of markets or sources of supply, although there are exemptions where competition is not eliminated.[45] Specific franchising laws vary among the countries. Several countries, including the U.K., Ireland, Germany, Denmark, the Netherlands and Portugal have no franchise-specific statute.[46] Legislation in Spain requires franchisors to register in the Franchisors' Registry and provide disclosure to prospective franchisees before signing an agreement or accepting a payment.[47] France and Italy have disclosure legislation requiring franchisors to provide disclosure before the execution of an agreement (20 and 30 days before execution, respectively).[48] Other countries that have adopted franchise regulatory legislation include Sweden,[49] Mexico, Belgium, Belarus, Lithuania and Estonia.[50]

As well, the European Franchise Federation has adopted a European Code of Ethics for Franchising. National franchise associations that are members of the Federation must require their member franchisors to accept and comply with the Code, and operate an accreditation scheme with checks to ensure that its voting franchisor members are complying. The Code obliges parties to a franchise to exercise fairness in their dealings with each other and lists essential terms that a franchise agreement must cover.[51]

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[44] *Treaty Establishing the European Community*, 24 December 2002, O.J. C 325, Article 81, online: <http://www.europa.eu.int/eur-lex/lex/en/treaties/dat/12002E/htm/12002E.html>.

[45] *Ibid.* See also U.S. Department of Commerce, *European Union: A Survey of Franchising in the European Union* by Jesse M. Lapierre (Belgium: U.S. Mission to the European Union, U.S. Commercial Service, December 19, 2005), online: <http://www.buyusa.gov/newengland/157.pdf>.

[46] *Franchising in the EU Member States*, online: European Franchising Network, Field Fisher Waterhouse LLP, London, England <http://www.europeanfranchising.com/franchisingineu/intro.aspx>.

[47] *Ibid.* See also UNIDROIT, *Legislation and Regulations Relevant to Franchising*, online: <http://www.unidroit.org/english/guides/2007franchising/annex.htm>.

[48] *Ibid.*

[49] See UNIDROIT, *Legislation and Regulations Relevant to Franchising – Sweden* (January 2007), online: <http://www.unidroit.org/english/guides/2007franchising/country/sweden.htm>.

[50] For a brief explanation of developments in these countries, see Edward N. Levitt, "Annual Legislative Update" (Paper presented to The Domino Effect: 6th Annual Franchising Conference, Ontario Bar Association, November 16, 2006). See also *F#: FFW's International Franchise Update*, Field Fisher Waterhouse LLP, London, England, online: <http://www.europeanfranchising.com/PDFs/FSharpSpring2006.pdf>.

[51] European Franchise Federation, *European Code of Ethics for Franchising*, online: <http://www.eff-franchise.com/codeofethics0.html>.

Work has also been underway on a model European Civil Code, which would include measures to regulate franchising. The Study Group on a European Civil Code, a network of academics from across the EU, aims to produce principles for private law rules to apply across Europe. A draft chapter on franchising contains pre-contractual disclosure provisions, as well as a number of provisions to regulate the franchise relationship throughout the term of the agreement.[52]

D. UNIDROIT

The International Institute for the Unification of Private Law (UNIDROIT) is an independent intergovernmental organization of 60 Member States instituted to "study needs and methods for modernising, harmonising and co-ordinating private and in particular commercial law as between States and groups of States".[53]

In 1985, the Canadian member of the Governing Council of UNIDROIT proposed that the organization consider the preparation of uniform rules on franchising.[54] At that time, franchising was a new development in Europe and was rare in other countries, with the exception of North America. However, franchisors' representatives opposed the concept of an international instrument, and UNIDROIT agreed to monitor franchising developments. Over time, interest in the development of an international franchise instrument grew, and in 1993 UNIDROIT established a Study Group on Franchising.[55] The renewed interest "was largely due to the increased attention devoted to franchising by legislators and the consequent proliferation of franchise laws, not all of which had, in the view of the members of the Study Group, given sufficient consideration to the specific nature and characteristics of franchising, thereby unintentionally putting the future development of franchising in the country concerned at risk".[56]

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[52] "An Uncivil Code?" *F#: FFW's International Franchise Update*, *supra* note 50. Draft relationship provisions include requirements imposed on the franchisor to provide ongoing assistance necessary to operate the business without charge, make reasonable efforts to promote and maintain the reputation of the franchise network and provide the franchisee ongoing information about matters such as market conditions and advertising campaigns. Franchisee obligations include the requirement to make reasonable efforts to operate the business according to the franchisor's business method, follow reasonable instructions, take reasonable care not to harm the network and allow reasonable access to the franchisor for checks and audits.

[53] UNIDROIT, *UNIDROIT : An Overview*, online: <http://www.unidroit.org/english/presentation/main.htm>. It was first established in 1926 as an auxiliary of the League of Nations, and re-established in 1940 by multilateral agreement. UNIDROIT now comprises 61 member States.

[54] UNIDROIT, *Model Franchise Disclosure Law* (Rome: September 2002), online: <http://www.unidroit.org/english/modellaws/2002franchise/2002modellaw-e.pdf>. The Explanatory Report notes that there had been "a number of instances of sharp practices within Canada that it was feared might spread also to other countries with the international expansion of franchising", at 11.

[55] *Ibid*. at 11-12.

[56] *Ibid*. at 14.

The Franchising Study Group prepared a *Guide to International Master Franchise Arrangements*,[57] published in February 1998, and a *Model Franchise Disclosure Law*,[58] submitted to the Governing Council in September 2002.

The UNIDROIT Model Law deals only with the disclosure obligations of franchisors; it does not address the relationship between the parties.[59] The Group considered approaches that included relationship provisions, such as "for example, whether the franchisee has a statutory right to renew the agreement, and whether the franchisee has a right to cure when he/she breaches the contract",[60] noting that the additional requirement for registration in some jurisdictions "considerably increased the burden that was placed on the franchisor".[61] However, the Group concluded that the experience of States with relationship legislation had been negative, and that while it was feasible to reach agreement on disclosure provisions, and therefore to attain a degree of uniformity, "it was far more problematic to devise common norms for relationship issues in view of the great variety of relationships that existed within the context of franchising".[62] As a result, the Group concluded that regulation at the international level should deal only with disclosure.

Under the Model Law, a franchisor must give a prospective franchisee a disclosure document at least 14 days before the signing of any agreement or the payment of a non-refundable deposit, other than a confidentiality agreement or a security deposit for a confidentiality agreement. Notice of any material change must be given as soon as practicable before an agreement or payment. The Model Law sets out a list of information that must be included in the disclosure document, but any format may be used.[63]

If the disclosure document or notice of material change is not delivered within the required time period or contains a misrepresentation or omission of a material fact, the franchisee may terminate the franchise agreement and/or claim damages, unless the franchisee had the information through other means, did not rely on the misrepresentation, or termination is a disproportionate remedy in the circumstances. Any waiver by a franchisee of a right under the Act is void.[64]

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[57] A second edition of the guide has since been published: UNIDROIT, *Guide to International Master Franchise Arrangements*, 2nd ed. (Rome: UNIDROIT, 2007). See Philip F. Zeidman, *The UNIDROIT Guide to International Master Franchise Arrangements: An Introduction and a Perspective*, online: <http://www.unidroit.org/english/publications/review/articles/1998-4.htm>.

[58] UNIDROIT, *supra* note 54.

[59] *Ibid*.

[60] *Ibid*. at 14.

[61] *Ibid*.

[62] *Ibid*.

[63] *Ibid*. at 3-8.

[64] *Ibid*. at 8-9.

CHAPTER 5

MANITOBA FRANCHISE LEGISLATION

Franchising has become prevalent in Canada and in other countries, and there is a trend toward regulation through franchise legislation, primarily with the aim of protecting franchisees. As outlined, the Canadian laws are principally disclosure statutes; while the parties are generally free to negotiate the terms of their agreements, franchisors must provide prospective franchisees full disclosure of all material information before a franchisee signs a franchise agreement or pays any money to the franchisor. A franchisee has the right to rescind the agreement and receive compensation if disclosure is not provided, and a right of action for damages if the franchisee suffers a loss as a result of a misrepresentation or a failure to comply with disclosure. The statutes also provide that the rights conferred by the Acts are in addition to and do not derogate from any other right or remedy that a party to a franchise agreement may have at common law.[1]

The Acts also include certain provisions governing the franchise relationship. They impose a duty of fair dealing, protect the right of franchisees to form or join an association of franchisees, and in some cases provide a process for the mediation of disputes. Many of the details, such as the contents and form of financial statements and other disclosure requirements, are set out by regulation.

The statutes do not require franchisors to register disclosure documents with a regulatory body, and, unlike the U.S and Australia, there is no Commission or other body charged with enforcement of the legislative requirements.

A. IS FRANCHISE LEGISLATION NEEDED IN MANITOBA?

The Commission's consultation paper posed the threshold question of whether franchise legislation is needed in Manitoba. As noted earlier, we have been unable to locate data that would provide reliable information about the franchising experience in Manitoba. While stark examples of ill treatment have reached the courts, it has not been possible to determine whether franchisors and franchisees in Manitoba tend to have positive or negative business relationships, or whether the franchising experience in Manitoba is similar to that of other provinces or countries. On the other hand, several respondents to the consultation paper reported their experience with issues and disputes that were very similar to those reported in other jurisdictions.

The principal argument against franchise legislation is that it may tend to have a chilling effect on the attractiveness of Manitoba as a business location. Increased regulation tends to impose additional costs and administrative burdens on franchisors that may become a disincentive to conducting business in the province.

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[1] *Franchises Act*, R.S.A. 2000, c. F-23 [*Alberta Act*]; *Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3 [*Ontario Act*]; *Franchises Act*, R.S.P.E.I. 1988, F-14.1 [*P.E.I. Act*], *Franchises Act*, S.N.B. 2007, c. F-23.5 [*New Brunswick Act*].

On the other hand, one can argue that the requirements of Canadian legislation to date are not particularly onerous, and that responsible franchisors would likely meet the minimum standards without regulation. Franchisors that are based in Alberta or Ontario, where legislation has been in place for some time, will already be familiar with the requirements of those jurisdictions, and franchisors in other provinces with aspirations to expand will need to meet those requirements if they wish to access larger markets. In addition, as respondents to the consultation paper pointed out, the Canadian Franchise Association has a large franchisor membership base, many of whom conduct business in Manitoba, and CFA members have been expected to comply with a mandatory disclosure policy for several years.[2] Further, franchisors entering Canada from the U.S. do so from an environment of regulatory restrictions with significant disclosure requirements. As a result, the argument that regulation has a chilling effect in relation to prospective franchisors grows less persuasive.

In fact, the requirements of franchise legislation in other Canadian jurisdictions may impose little more than good business practices, and some commentators advise franchisors to use one of the disclosure models even when operating in a non-regulated province, "in order to build the goodwill of their brand in that jurisdiction and more importantly to embrace practices which will reduce unnecessary exposure to litigation for misrepresentation".[3]

The Franchising Policy Council of Australia has described the Australian experience, suggesting that, while regulation does impose a cost, it may also benefit responsible franchisors and the franchise industry as a whole:

> Mandatory regulation of an industry can involve a compliance burden and a cost. The consensus of the franchising industry was that such a burden and cost was worthwhile if the benefit was an informed and responsible industry. The franchising industry was prepared to seek protective statutory mechanisms to combat the small number of unscrupulous operators who had the potential to tarnish the image of the whole industry.[4]

The Council concluded that "the costs are worthwhile considering the benefits that the … Code provides to the franchising industry".[5]

Others have suggested that if the compliance burden and costs prevent franchisors that are not financially secure from attempting to franchise, this is an appropriate result. As one respondent to the consultation paper observed:

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[2] Submission by the Canadian Franchise Association (July 30, 2007); submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007); submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007). As Schwartz, Pozios and Zylberman note, this includes such franchisors as A&W, Orange Julius, Boston Pizza, Canadian Tire, Pizza Hut, Play It Again Sports, Second Cup and Dairy Queen.

[3] Richard D. Leblanc and Peter M. Dillon, "Franchise Disclosure in Canada in 2007 and Beyond" (Paper presented to The Domino Effect: 6th Annual Franchising Conference, Ontario Bar Association, November 16, 2006) at 7-8. The Canadian Franchise Association also requires its members to provide a minimum level of disclosure: see Canadian Franchise Association, *CFA Disclosure Rules*, online: <http://www.cfa.ca/Page.aspx?URL=CFA DisclosureRules.html>.

[4] Austl., Commonwealth, Franchising Policy Council, *Review of the Franchising Code of Conduct: Report of the Franchising Policy Council* (Canberra: Secretariat, Office of Small Business, May 2000) at 14-15.

[5] *Ibid.* at 56.

> If a potential franchisor does not have sufficient funds to pay the legal and accounting costs for preparing the disclosure document, the franchisor should not be allowed to sell franchises to the unsuspecting and unsophisticated public.[6]

The responses to the consultation paper on this threshold question were consistent. Each respondent who addressed the issue supported the enactment of franchise legislation in Manitoba,[7] and no respondent opposed the concept. Regardless of the number of franchised businesses operating in Manitoba, or of the nature of the franchising environment relative to other jurisdictions, the consequences to a single franchisee who is misled by a franchisor may be significant. While the common law provides some remedies for unconscionable tactics, current Canadian franchise legislation ensures increased transparency, provides greater protection for franchisees and enables prospective franchisees to make more informed business decisions.

In the Commission's view, it is difficult to support an argument that a Manitoba franchisee entering into a business relationship with any franchisor, reputable or otherwise, should not be entitled to disclosure that is at least equivalent to that afforded a franchisee in another Canadian jurisdiction. In addition, a choice not to regulate may risk the development of a reputation for Manitoba as a haven for incompetent or disreputable franchisors. One respondent gave the following example:

> Manitoba franchisees are at a significant disadvantage compared to franchisees in those provinces with franchise disclosure legislation. We have the situation that an Alberta franchisor who, in the sale of a franchise in the Province of Alberta, must provide its franchisees with full disclosure information as required by Alberta law, but does not and is not required to provide the same information to a Manitoba franchisee. The same applies to franchisors from Ontario. In many cases, the Alberta or Ontario franchisor provides the disclosure information voluntarily but there are circumstances, with which I have had personal experience, where an Alberta or Ontario franchisor simply refused to provide disclosure information to a prospective Manitoba franchisee with the ultimate result that the franchisee purchased a business which was not viable and within a year or so was insolvent and lost its total investment in excess of $150,000. A disclosure document would have shown this franchisee the numerous problems these franchisors had.[8]

Recognizing that franchisors must meet legislated requirements in other Canadian provinces and in the U.S., the Commission is persuaded that any additional costs imposed by franchise legislation in Manitoba will not be a significant barrier to those franchisors that have

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[6] Submission by A.L. Weinberg (July 18, 2007) at 4.

[7] Submission by E. Levitt (July 19, 2007); submission by the Manitoba Motor Dealers Association Inc. (July 27, 2007); submission by the Canadian Franchise Association (July 30, 2007); submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007); submission by the Independent Retail Grocers' Association (July 31, 2007); submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007); submission by A. Donald (August 19, 2007); submission by the Canadian Federation of Independent Grocers (August 2007).

[8] Submission by A.L. Weinberg (July 18, 2007) at 3-4.

achieved a measure of financial viability,[9] and that regulation may benefit not only franchisees, but also responsible franchisors and the franchise industry as a whole. As one respondent said, "we do not believe that Manitoba should deny prospective franchisees the benefit of franchise disclosure legislation which they would otherwise be entitled to receive in four provinces in Canada".[10] The Commission concurs.

RECOMMENDATION 1

Manitoba should enact legislation to regulate franchising.

B. UNIFORMITY

Although respondents to the consultation paper agreed that franchise legislation is needed in Manitoba, there were differences of opinion with respect to the elements that should be included.

The Commission observed in the consultation paper that some degree of uniformity between franchise legislation in Manitoba and the legislation of other provinces will no doubt be desired. The trend toward harmonized franchise legislation in Canada is consistent with the principles of the *Agreement on Internal Trade*[11] and can be expected to contribute clarity and certainty to the commercial franchise environment. If regulatory requirements are consistent across provincial boundaries, barriers to the movement of goods, services and investment may be reduced, and franchisors will have little non-market incentive to choose to conduct business in one province over another.

Several respondents declared support for legislative harmonization or uniformity.[12] One submission expressed that "[w]e strongly urge that the province of Manitoba, if it decides to introduce legislation to regulate franchising, should proceed on the principle of achieving uniformity with the franchise legislation of other provinces in Canada to the maximum extent possible".[13] Similarly, another respondent urged consistency with existing provincial legislation:

> Firstly, the lack of consistency amongst provinces would be an unnecessary hardship for all concerned and would work to diminish the benefits of franchising in Canada. Secondly, the existing legislation has, in a number of ways, been well considered and

[9] For example, a practitioner with over thirty years of franchise law experience commented that "it is my belief that the existence of such legislation in any of the provinces has minimal to no effect on the decision of franchisors to operate in the province": submission by E. Levitt (July 19, 2007) at 2.

[10] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 3.

[11] *Agreement on Internal Trade*, September 1994, online: <http://www.ait-aci.ca/index_en/ait.htm>.

[12] Submission by E. Levitt (July 19, 2007); submission by the Canadian Franchise Association (July 30, 2007); submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007); submission by the TDL Group Corp. (Tim Hortons) (July 31, 2007); submission by B. Macallum (August 20, 2007).

[13] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 4.

> thoroughly debated and, therefore, in all likelihood presents the best balance, for the time being, for franchise legislation in Canada".[14]

The Commission was urged to support a legal framework "that does not create a patchwork of similar, but different, statutes across Canada".[15] Another respondent noted that "[s]ince we are likely to continue to observe increased interdependence of trade both within Canada and on the global stage the need for domestic legislation to consider harmonization objectives will be important".[16]

The existing Canadian statutes are relatively consistent in their approach to franchise regulation, focusing to a large extent on pre-contractual disclosure, with limited provisions governing the franchise relationship. Remedies under the statutes are obtained through private rights of action; the registration of a disclosure document is not required and there is no independent body involved in administration or enforcement. As one submission noted "[a]ll jurisdictions have adopted or recommended that pre-contractual disclosure legislation with limited general relationship standards is the most desirable form of franchise legislation. We suggest that Manitoba follow that model".[17]

The Commission shares the view, endorsed within Canada and internationally, that pre-sale disclosure is an essential principle of franchise legislation. The Commission also acknowledges that harmonization is an important objective, and that to the extent that uniformity is achieved, it will help to minimize any burden that Manitoba franchise legislation may impose on franchisors. Many existing legislative concepts will have been incorporated into the business practices of franchisors operating in other Canadian jurisdictions. On the other hand, only four franchise statutes currently exist within Canada, and while they follow similar models, the statutes are not identical. There are meaningful differences, particularly in the area of franchisor disclosure requirements.

In the Commission's view, uniformity in legislative structure and fundamental concepts is a desirable principle for franchise legislation. A number of respondents specifically supported the ULCC Model Bill and disclosure regulation (the Model Regulation) as a model for Manitoba legislation.[18] As discussed earlier, the Model Bill was based largely on the Ontario Act, although it incorporates certain provisions from the Alberta Act. While there have been criticisms of the Model Bill format, it was pointed out that it is widely accepted in Canada,[19] and the two

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[14] Submission by E. Levitt (July 19, 2007) at 2.

[15] Submission by the Association of Equipment Manufacturers (October 1, 2007) at 1.

[16] Submission by B. Macallum (August 20, 2007) at 1.

[17] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 4.

[18] Uniform Law Conference of Canada, *Uniform Franchises Act*, online: <http://www.ulcc.ca/en/us/Uniform_Franchises_Act_En.pdf> [*ULCC Model Bill*]; Uniform Law Conference of Canada, *Disclosure Documents Regulation*, online: <http://www.ulcc.ca/en/us/UFA_Disclosure_Documents_Reg_En.pdf> [*ULCC Model Regulation*]; submission by the Canadian Franchise Association (July 30, 2007); submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007); submission by the TDL Group Corp. (Tim Hortons) (July 31, 2007); submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007).

[19] Submission by the Canadian Franchise Association (July 30, 2007).

provinces that have enacted legislation since the Model Bill was drafted have largely followed the Model Bill. The Commission agrees that the use of a standard format would help to ensure consistency of interpretation and facilitate compliance.

Beyond the underlying concepts, however, the existing Canadian schemes are similar, but not uniform. Most Canadian franchise statues are relatively young, and with respect to the Ontario Act and regulations in particular, many commentators have made recommendations for improvement and no doubt amendments will be made in the future. The Ontario Bar Association Joint Subcommittee on Franchising has submitted a report to the Ontario Government recommending a number of improvements to the Ontario franchise regulation that, if implemented, would result in significant changes.[20] In the Commission's view, while consistency is to be valued, uniformity does not currently exist within Canadian franchise legislation. Further, the role of the Commission is to recommend those improvements to the law that we consider necessary or appropriate; the desire for uniformity should not prevent Manitoba from departing from existing concepts where scope for improvement exists.

In the remainder of this report, the Commission makes several recommendations for the content of franchise legislation in Manitoba. Where no recommendations to the contrary are made, the Commission agrees with the approach taken in the ULCC Model Bill and disclosure regulation.

RECOMMENDATION 2

The Uniform Law Conference of Canada* Uniform Franchises Act *("the ULCC Model Bill") and* Disclosure Documents Regulation *("the ULCC Model Regulation") should be used as the model structure for Manitoba franchise legislation and regulations.

C. APPLICATION

1. Definition of "Franchise"

The Canadian Acts[21] have a broad definition of "franchise". The ULCC Model Bill provides as follows:

> "franchise" means a right to engage in a business where the franchisee is required by contract or otherwise to make a payment or continuing payments, whether direct or indirect, or a commitment to make such payment or payments, to the franchisor or the franchisor's associate in the course of operating the business or as a condition of

[20] Ontario Bar Association Joint Subcommittee on Franchising Franchise Disclosure Working Group, *Report on Ontario Regulation 581/00* (Toronto: Ontario Bar Association, November, 2006) [OBA Joint Subcommittee on Franchising].

[21] In this report, unless otherwise indicated, a reference to the "Acts" includes the ULCC Model Bill: *ULCC Model Bill*, *supra* note 18.

acquiring the franchise or commencing operations and,

(a) in which,

(i) the franchisor grants the franchisee the right to sell, offer for sale or distribute goods or services that are substantially associated with the franchisor's, or the franchisor's associate's, trade-mark, trade name, logo or advertising or other commercial symbol, and

(ii) the franchisor or the franchisor's associate exercises significant control over, or offers significant assistance in, the franchisee's method of operation, including building design and furnishings, locations, business organization, marketing techniques or training, or

(b) in which,

(i) the franchisor or the franchisor's associate grants the franchisee the representational or distribution rights, whether or not a trade-mark, trade name, logo or advertising or other commercial symbol is involved, to sell, offer for sale or distribute goods or services supplied by the franchisor or a supplier designated by the franchisor, and

(ii) the franchisor or the franchisor's associate or a third person designated by the franchisor, provides location assistance, 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.[22]

This definition is based on the Ontario Act, and was adopted in the P.E.I. and New Brunswick Acts. The Ontario and Alberta Acts refer to a "service mark" as well as a trademark, and the Alberta Act is slightly narrower in scope. According to the ULCC Uniform Franchises Act Working Group, "[a]n inclusive definition of franchise was chosen in order to capture a wide range of relationships subject to requirements such as fair dealing but also to exempt certain others (i.e. business opportunities or multilevel marketing) from the disclosure requirements".[23]

Unlike the Ontario and Alberta Acts, the Model Bill definition does not include the term "service mark". The term "service mark" is used in American trademarks legislation but not in Canada, and its use appears to be an anomaly arising from early reliance on American precedent.[24]

The definition is intended to capture relationships in which attempts are made to conceal franchise fees in an effort to avoid characterization of the arrangement as a franchise. There has been commentary about the definition, both in the U.S. and Canada, and there will be some uncertainty in specific fact situations as to whether a business relationship is captured by the

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[22] ULCC Model Bill, *supra* note 18, s. 1(1).

[23] Uniform Law Conference of Canada, Uniform Franchises Act Working Group, *Uniform Franchises Act with Commentary* at 2, online: <http://www.ulcc.ca/en/poam2/CLS2004_Uniform_Franchise_Act_and_Commentary_En.pdf> [ULCC, *Uniform Franchises Act Working Group Commentary*].

[24] It has been suggested that, since there is no concept of a "service mark" in the *Trade-marks Act*, R.S., 1985, c. T-13, the presence of this term "is an indicator of the degree [of] American influence in the drafting of the Canadian statutes", Paul D. Jones and Daniel F. So, "Houdini's Franchise Law: Exclusions and Exemptions to Disclosure in Canada" (Paper presented to The Domino Effect: 6th Annual Franchising Conference, Ontario Bar Association, November 16, 2006) at 20.

definition.[25] However, certainty will increase over time as questions are determined by the courts. As well, the definition is similar in many respects to the wording in the U.S. FTC Franchise Rule, and statements and interpretations issued by the FTC may be of assistance.[26]

In the Commission's view, any shortcomings that have been raised are not sufficient to warrant a departure from the principle of uniformity with other jurisdictions. Uniformity is particularly important in this context; a business system that is a franchise in one province should be a franchise in the next.

RECOMMENDATION 3

The definition of "franchise" in the Act should be consistent with the definition in the ULCC Model Bill.

2. Exclusions

(a) Employment Relationships, Partnerships, Cooperatives and Oral Agreements

All Acts except Alberta's exclude employer-employee relationships, partnerships and cooperative organizations of independent businesses from the application of the Act. In addition, the ULCC Model Bill and the Alberta, P.E.I. and New Brunswick Acts exclude arrangements for the purchase and sale of a reasonable amount of goods at reasonable wholesale prices or a reasonable amount of services at a reasonable price.[27] The exception for the purchase of goods and services is intended to capture relationships in which a purchaser may enter into a wholesale

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[25] See for example, Jones and So, *ibid.* at 17-25, and the commentary on the Ontario definition in Frank Zaid, *Franchise Law* (Toronto: Irwin Law, 2005) at 40-42: motor vehicle dealers, farm implement dealers, gasoline retailers, soft drink distributors and others may, depending on the facts, inadvertently fall within the definition of "franchise". The Ontario definition has been criticized for having the potential to capture many organizations that do not identify themselves as a "franchise": see Peter Dillon, "Ontario Franchise Developments in 2004: Has the Pendulum Finished Swinging Yet?" *Siskinds Collection of Franchise Law Articles* (FRAN/RP-016, June 15, 2005) (QL) [Dillon, "Ontario Franchise Developments in 2004"], and Robert Glass, Peter M. Dillon and Michael Robinson, "Accidental Franchises: If It Walks Like a Duck and Quacks Like a Duck…" *Siskinds Collection of Franchise Law Articles* (FRAN/RP-014, December 15, 2004) (QL).

[26] *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures,* 16 C.F.R. § 436 [*FTC Franchise Rule*]. For example, the question of how much assistance or control is "significant" has not yet been answered in Canada, but the FTC Franchise Rule also uses the concept. The FTC has maintained that the term "relates to the degree to which the franchisee's potential for success depends on the franchisor's superior business expertise": John M. Sotos and Arthur J. Trebilcock, "Disclosure Issues in a National and Global Environment: Using an Ontario Disclosure Document in Another Province" (Paper presented to Today's Canadian Franchise Lawyer – Practising Locally in a Global Industry: 7th Annual Franchise Law Conference, Ontario Bar Association, November 15, 2007) at 7.

[27] The Alberta Act also excludes the payment of a reasonable service charge to the issuer of a debit or credit card by an establishment accepting the card: *Alberta Act*, *supra* note 1, s. 1(1)(f)(iii). However, notwithstanding the inclusive definition of "franchise", it seems unlikely that this service would be interpreted to constitute a franchise and the exclusion has not been adopted in other jurisdictions.

purchase agreement but has a genuine option whether to purchase the goods from the supplier and regarding how much to purchase. All Acts also provide that they do not apply to a relationship arising out of an oral agreement where nothing in writing evidences any term or aspect of the relationship.[28]

In the Commission's opinion, the exceptions for employment relationships, partnerships and cooperative organizations and for the purchase of reasonable amounts of goods and services are sensible exclusions for relationships that have fundamentally different characteristics from a franchise relationship.

Under the Alberta Act, the wholesale purchase of goods and services is excluded by virtue of the definition of "franchise fee"; in the other Acts a subsection sets out the types of commercial relationships that are not governed by the statute. The latter approach is clearer and easier to understand.

RECOMMENDATION 4

The Act should provide that it does not apply to:

- ***an employer-employee relationship;***
- ***a partnership;***
- ***a cooperative association of independent businesses;***
- ***a relationship arising out of an oral agreement where no term or aspect of the agreement is in writing; or***
- ***an arrangement for the purchase and sale of a reasonable amount of goods at reasonable wholesale prices or a reasonable amount of services at a reasonable price.***

(b) Leased Departments

Section 2 of the Ontario Act provides that the Act does not apply to "leased departments" - arrangements whereby a retailer leases space in the premises of a larger retailer and is not required or advised to buy the goods or services it sells from the lessor or its affiliate. An example is the rental of space in a department store for the sale of sunglasses or jewellery.

In some cases, in the absence of an exemption, a leased department arrangement will fall within the technical definition of a franchise, because the lessee may become associated with the lessor's trade-mark and the lessor may exercise a measure of control over the retail operations, such as by setting operating hour requirements. The Alberta Act exempts these arrangements from the franchise disclosure provisions, rather than from the application of the entire Act. The Model Bill and the P.E.I. and New Brunswick Acts do not exempt leased departments.

[28] This exemption was also retained in the amended FTC Franchise Rule, *supra* note 26: 16 C.F.R. § 436.2(a)(3)(iv).

The amended FTC Rule retains the previous Rule's exemption for leased departments:

> [T]hese types of relationships need not be protected by the Rule because the likelihood of deception is not great, the retailer-lessee typically being experienced and able to assess the value of the location. Moreover, the risk is small because the retailer-lessee's financial liability to the retailer-grantor is limited to rent.[29]

The FTC Rule does not include a duty of fair dealing, and so exemption from the Rule is an exemption from the requirement to disclose information only.

As Sotos and Trebilcock note, the Ontario approach means that a leased department arrangement that falls within the definition of a franchise is exempt from the duty of fair dealing and right of association provisions as well as from the disclosure requirements, even where an element of control may exist. In their view, while leased departments may have originated as commercial tenancies, as they have evolved there is little to distinguish them from other franchises, in the nature of their operations and their exposure to risk. The lessor may require the payment of initial and ongoing fees, leasehold improvements that conform to its standards and involve a mark-up, and participation in marketing programs, and may control the lessee's retail pricing policies, rights of sale or transfer and refund and warranty policies. As a result, the lessee is subject to the kinds of risks to which franchisees are exposed.[30]

The Commission agrees that where a leased department falls within the definition of a franchise, disclosure obligations are not warranted. However, the broader obligations of the franchise statute should still apply.

RECOMMENDATION 5

The Act should exempt "leased department" arrangements from the requirement to provide disclosure but not generally from the application of the Act.

D. DISCLOSURE ELEMENTS

Pre-contractual disclosure is the central principle of franchise legislation in Canada and in other countries. All Canadian Acts require franchisors to disclose specified information about

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[29] U.S. Federal Trade Commission, *16 CFR Parts 436 and 437: Disclosure Requirements and Prohibitions Concerning Franchising; Disclosure Requirements and Prohibitions Concerning Business Opportunities; Final Rule* (2007) at 15462, online: <http://www.ftc.gov/os/2007/01/R511003FranchiseRuleFRNotice.pdf> [U.S. Federal Trade Commission, *Final Rule*].

[30] John M. Sotos and Arthur J. Trebilcock, "Canadian Franchise Disclosure Statutes: Exemptions and Exclusions – Analysis and Recommendations" (Paper submitted to the 2008 Franchise Law Symposium, Marcel A. Desautels Centre for Private Enterprise and the Law and Asper Chair of International Business and Trade Law, March 14, 2008) at 21-22 [Sotos and Trebilcock, "Exemptions and Exclusions"]; email correspondence with John M. Sotos (May 16, 2008).

the franchise to a prospective franchisee at least 14 days before an agreement relating to the franchise is signed, or (except in Alberta) before any money is paid in relation to the franchise. In Alberta, a franchisor may take a refundable good faith deposit before providing disclosure. Under each of the statutes, the franchisor must also disclose all material facts. In addition, the franchisor must provide written statements of any material changes that occur between the provision of the original disclosure document and the signing of a franchise agreement or the payment of money toward the franchise.

Most of the details of the disclosure requirements are set out by regulation. There are several exemptions to the disclosure requirements; for example, disclosure is not required when a franchise is granted to an officer or director of the franchisor or an additional franchise is granted to an existing franchisee.

1. Open-Ended Disclosure of Material Facts

In addition to requiring disclosure of the information specifically identified in the regulations (discussed below), all Canadian statutes or regulations also require franchisors to disclose all "material facts".[31] "Material fact" is generally defined to include any information about the business, operations, capital or control of the franchise that would reasonably be expected to have a significant effect on the value or price of the franchise or the decision to acquire the franchise.

In contrast, the U.S. FTC Rule requires disclosure of only the items of information that are listed; the list is extensive, but there is no requirement to disclose anything that is not identified.

The wording of the Acts differs slightly. The Ontario and P.E.I. Acts require the disclosure of all material facts "including material facts as prescribed",[32] and there has been debate in Ontario over both the requirement to disclose all material facts and its wording. Apparently, some franchisors have chosen to limit their disclosure to the items that are specifically listed in the regulations:

> The scope of what might constitute a "material fact" pursuant to this definition is limitless and there exists an ongoing debate between certain commentators as to the standard of disclosure required … The Ontario Act introduces confusion by deeming as material facts the prescribed disclosures required in the regulation, effectively requiring their disclosure whether actually material or not. The reaction of franchisors and the franchise bar to this wording has been in some cases to interpret the regulation as definitive of the standard of disclosure in similarity with the rules-based UFOC

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[31] This requirement is included in the Ontario, P.E.I. and New Brunswick statutes and in the ULCC Model Bill. In Alberta, the requirement to disclose all material facts is set out by regulation: *Franchises Regulation*, Alta. Reg. 240/95, s. 2(1) [*Alberta Regulation*].

[32] *Ontario Act*, *supra* note 1, s. 5(4); *P.E.I. Act*, *supra* note 1, s. 5(4). This is similar to s. 2(1) of the Alberta Regulation, which provides that "a disclosure document must contain all material facts including material facts relating to the matters set out in Schedule 1": *Alberta Regulation*, *ibid*.

> Guidelines in the U.S. On this basis, many franchisors do not purport to make disclosures of any information which is not specifically requested in the regulation. At the other end of the spectrum exists the school of thought that all facts howsoever vaguely material should be disclosed …[33]

On the other hand, there are persuasive arguments that the scope of disclosure required is broad.[34] In *1518628 Ontario Inc. v. Tutor Time Learning Centres LLC*,[35] it was held that information about serious problems with the accounts, billings and financial arrangements and the overall management of the franchise, although not specifically identified by regulation, constituted "material facts" that should have been disclosed; the information would have impacted on the decision of any reasonable person to proceed with the transfer of an interest in the franchise.

The Ontario Bar Association Joint Subcommittee on Franchising has commented that:

> [c]lause 5(4)(a) of the *Arthur Wishart Act (Franchise Disclosure), 2000* requires that a disclosure document contain all material facts; should a franchisor ignore this clause, then the consequences to the franchisor, its franchisor associates, brokers, agents and those who sign the certificate can be severe.
>
> Despite this, however, it appears to us that a great many franchisors and their professional advisors continue to believe that an Ontario franchise disclosure document need only respond to the requirements of Part II of O.Reg. 581/00, and include a recent financial statement, the principal franchise contracts, and a certificate of disclosure. Indeed, in a recently reported case the learned judge in *obiter* said that Part II of O.Reg. 581/00 "determines the information to be included in the disclosure document".[36]

The Commission does not agree with the view that if information is not specifically identified it need not be disclosed. Rather, where an item is not identified, it "does not mean that there is no obligation to disclose it, but only that the franchisor must determine whether the item

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[33] Leblanc and Dillon, *supra* note 3 at 11.

[34] See Arthur J. Trebilcock, "Disclosure – The Advanced Course: Tricky Disclosure Issues and Some Drafting Tips" (Paper presented to The Domino Effect: 6th Annual Franchising Conference, Ontario Bar Association, November 16, 2006). Levitt agrees, noting that "[t]he conservative advice is to disclose any fact that could possibly be construed as material": Edward N. Levitt, "Annual Legislative Update" (Paper presented to The Domino Effect: 6th Annual Franchising Conference, Ontario Bar Association, November 16, 2006) at 21 [Levitt, "Annual Legislative Update 2006"]. This could include trends in the industry, anticipated new regulations, local market conditions and supply issues and more: Edward N. Levitt, *The Arthur Wishart Act (Franchise Disclosure), 2000: Critical Compliance Issues*, online: <http://www.gowlings.com/resources/publications.asp?pubid=1146 [Levitt, *Critical Compliance Issues*].

[35] [2006] O.J. No. 3011 at para. 63 (QL) (S.C.J.); leave to appeal on other grounds granted [2006] O.J. No. 4992 (Div. Ct.). See Jennifer Dolman and Andraya Frith, "Ontario's Franchise Legislation – What Have We Learned" (Winter 2007) 26 *Franchise L.J.* 136, online: <http://www.osler.com/uploadedFiles/Resources/Publications/Osler HoskinHarcourtLLP_FranchiseLaw-DolmanFrith.pdf>.

[36] OBA Joint Subcommittee on Franchising, *supra* note 20, Executive Summary, citing *Walden v. 887985 Alberta Ltd. (cob Ag Connexions)*, [2005] O.J. No. 247 (QL) (S.C.J.).

is a material fact relevant to the prospective franchisee".[37] The wording of the ULCC Model Bill and the New Brunswick Act is clearer on this point; in both Acts subsection 5(5) provides that "in addition to the statements, documents and information required by subsection (4), the disclosure document shall contain all material facts".[38]

The "open-ended" requirement to disclose all material facts, in contrast to the disclosure of enumerated items only, has also been criticized as introducing risk and uncertainty that is unfair to franchisors and harmful to franchising generally.[39] On the other hand, the requirement to disclose all material facts is a familiar and established principle of securities law,[40] and this approach has been taken in all other Canadian franchise statutes. Later in this report, we make recommendations for franchise disclosure requirements with the aim of providing more guidance and certainty to franchisors with respect to their obligations. However, as one respondent commented, "in my experience no matter how detailed one is in preparing any list, there is always something unexpected or unanticipated left out".[41] In the Commission's view, given the imbalance in information available to the parties at the time of a franchise purchase, a requirement to disclose all material facts that would be expected to have a significant effect on the value of the franchise or the decision to acquire the franchise (discussed in more detail below) is clearly appropriate.

RECOMMENDATION 6

The Act should provide that, in addition to the financial statements, documents and other information specifically required by the Act or regulations, the disclosure document must contain all material facts.

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[37] Frank Zaid, "A Review of Franchise Disclosure Laws in Canada" (Paper presented to The Domino Effect: 6th Annual Franchising Conference, Ontario Bar Association, November 16, 2006) at 12 [Zaid, "Franchise Disclosure Laws"].

[38] *P.E.I. Act*, *supra* note 1; *ULCC Model Bill*, *supra* note 18. This is similar to the recommendation by the Ontario Bar Association Joint Subcommittee on Franchising that the Ontario regulations be amended to provide that "[n]othing in this Regulation limits the obligation in clause 5(4)(a) of the Act to disclose all material facts: OBA Joint Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 3.

[39] Peter M. Dillon, *Interested in Increasing Legislative Harmony Within North America? Let's Start With Ontario*, online: Siskinds Canadian Franchise Lawyers <http://www.franchiselaw.ca/articles.asp> [Dillon, *Increasing Legislative Harmony*]; Peter M. Dillon, "Ontario's Franchise Regulatory Regime: Why Ontario Should Get Active in NASAA", *Siskinds Collection of Franchise Law Articles* (FRAN/RP-005, January 15, 2004) (QL) [Dillon, "Why Ontario Should Get Active in NASAA"]. The author suggests that the simplest solution at this point for Ontario would be the addition of a "substantially complete" saving provision (a provision that a disclosure document is properly given if it is substantially complete).

[40] See Manitoba's *Securities Act*, C.C.S.M., c. S50.

[41] Submission by A.L. Weinberg (July 18, 2007) at 5.

2. Definition of "Material Fact"

The definition of "material fact" in the Model Bill provides:

> "material fact" means any information, 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.[42]

This definition is also used in the P.E.I. and New Brunswick Acts and in the Alberta Act (although it substitutes "purchase" for "acquire"). The definition in the Ontario Act is broader:

> "material fact" includes any information about the business, operations, capital or control of the franchisor or franchisor's associate or about 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.[43]

Although it refers to the same type of information, the Ontario Act provides that "material fact includes…" rather than "material fact means"…, which would imply that a franchisor could be obliged to disclose information in addition to the information described in the definition.[44] Since the Ontario Act was enacted after the Alberta Act, this broadened disclosure obligation would appear to be intentional.

On the other hand, the Ontario and Alberta definitions do not include information about "the franchise" in addition to the franchise system. The Model Bill, the P.E.I. Act and the New Brunswick Act require disclosure of information about the franchise, which arguably expands the definition's scope.

All Canadian franchise statutes also require a franchisor to provide a prospective franchisee a written statement of any material change that occurs after a disclosure document has been provided and before the franchisee signs any franchise agreement or pays any consideration toward the franchise. The definition of "material change" is similar to that of "material fact". In the ULCC Model Bill:

> "material change" means a change, in the business, operations, capital or control of the franchisor or franchisor's associate or in the franchise or the franchise system, that would reasonably be expected to have a significant adverse effect on the value or price of the franchise to be granted or on the decision to acquire the franchise and includes a decision to implement such a change made by the board of directors of the franchisor or franchisor's associate or by senior management of the franchisor or franchisor's associate who believe that confirmation of the decision by the board of directors is probable.[45]

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[42] *ULCC Model Bill*, *supra* note 18, s. 1(1).

[43] *Ontario Act*, *supra* note 1, s. 1(1).

[44] In other words, a franchisor might include all of the information described in the definition and still fail to disclose all material facts: see Zaid, "Franchise Disclosure Laws", *supra* note 37 at 13.

[45] *ULCC Model Bill*, *supra* note 18, s. 1(1).

The definitions of "material fact" and "material change" are modeled after securities legislation, but the definition of "material fact" in franchise legislation is narrower (with the possible exception of the Ontario Act). Under the Manitoba *Securities Act*,[46] and other Canadian securities legislation, the definition of "material fact" is defined in terms of a fact that significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of securities. It is not confined to information about the business, operations, capital or control of the issuer.

In contrast, the definition of "material change" in securities legislation is similar to the definition in franchise legislation; "material change" is defined in terms of a change *in the business, operations or capital of the issuer* that would reasonably be expected to have a significant effect on the market price or value of securities.[47]

The difference in wording between these terms is meaningful. In *Kerr v. Danier Leather Inc.*,[48] the Supreme Court of Canada recently considered the distinction in terminology in the context of the disclosure obligations of an issuer of a prospectus under the Ontario *Securities Act*.[49] The issue was Danier's failure to disclose intra-quarterly sales results that did not meet the prospectus sales forecast. The court noted that "material fact" was defined more broadly than "material change", as "material fact" was not restricted to matters related to the business, operations or capital of the issuer. While the trial judge had held that the information did fall within the definition of a material fact, the Supreme Court held that the change between the forecast and the intra-quarterly results was not a material change, because it was not a change in the business, operations or capital of the issuer. As a result, disclosure was not required.[50]

The court noted that the obligations for ongoing disclosure under the Act are lower in relation to material facts, and that the distinction between material fact and material change is deliberate and policy-based. The court quoted a former chairman of the Ontario Securities Commission:

> The term "material fact" is necessary when an issuer is publishing a disclosure document … where all material information concerning the issuer at a point in time is published in one document which is convenient to the investor. The term "material change" is limited to a change in the business, operations or capital of the issuer. This is an attempt to relieve reporting issuers of the obligation to continually interpret external political,

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[46] *Supra* note 40, ss. 108(1), 140.1.

[47] *Ibid.*, ss. 1(1), 108(1).

[48] 2007 SCC 44, 286 D.L.R. (4th) 601.

[49] R.S.O. 1990, c. S.5.

[50] The decision is also significant in that the court held that disclosure is a matter of legal obligation, and the disclosure requirements under the Act are not subject to deference under the business judgment rule. Subsequent to the Supreme Court decision, the Ontario Securities Commission found that merger negotiations occurring before the signing of a merger agreement constituted a material fact, but not a material change. The OSC noted that in some circumstances a material change could occur before the signing of an agreement if both parties are committed to proceed and there is a substantial likelihood that the merger will be completed: *Re AiT Advanced Information Technologies Corp.* (2008), 31 OSCB 712, 2008 LNONOSC 22 (QL).

> economic and social developments as they affect the affairs of the issuer, unless the external change will result in a change in the business, operations or capital of the issuer, in which case, timely disclosure of the change must be made.[51]

It appears that the use of a more narrow definition of "material fact" in franchise legislation was deliberate, to avoid imposing an obligation on franchisors to disclose external political, economic, social or regulatory influences that could affect the franchise. The definition in Canadian legislation is also narrower than that of the former FTC Rule, which provided:

> The terms "material," "material fact," and "material change" shall include any fact, circumstance, or set of conditions which has a substantial likelihood of influencing a reasonable franchisee or a reasonable prospective franchisee in the making of a significant decision relating to a named franchise business or which has any significant financial impact on a franchisee or prospective franchisee.[52]

On the other hand, the use of the term "includes" in the Ontario definition suggests that franchisors in that province may be required to disclose a broader range of external factors. The Ontario definition has been suggested to be equivalent to the standard for disclosure under securities legislation.[53]

In some cases, the broader standard for disclosure may be appropriate:

> Because the definition in 1(1) uses the word "includes" rather than "means", many franchisors will have to disclose information unrelated to the business, operations, capital or control of the franchisor, the franchisor's associate or the franchise system. Consider, for example, a situation where an affiliate of the franchisor, who is not the "franchisor's associate" (because it is not involved in marketing or granting the franchises, nor in supplying the franchisor's system), operates a competing franchise system under a different trade-mark. Note that Ontario Regulation: 2(1) (viii) and 6(1) (14) do not require disclosure of this obviously material information."[54]

The use of the broad securities law definition of "material fact" is an appealing option. However, there are important differences between a franchise sale and a securities issue that support more extensive disclosure requirements in the securities context:

> First, the prospective investor in securities has no real opportunity to independently investigate the underlying business, but must rely almost entirely on the prospectus. In contrast, the prospective franchisee can visit existing and former franchisees to ask lots

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[51] *Supra* note 48 at para. 38, quoting the remarks of Peter J. Dey concerning disclosure under the Ontario *Securities Act* made to securities lawyers in Calgary and Toronto on June 7 and 9, 1983 [emphasis added by the court].

[52] *FTC Franchise Rule*, *supra* note 26, 16 C.F.R. § 436.2(n) (before amendment); note that the revised FTC Rule no longer defines "material fact": see U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15455-15456.

[53] John M. Sotos and Arthur J. Trebilcock, "Disclosure Issues in a National and Global Environment: "Just Give Us The (Material) Facts, Ma'am"" (Paper presented to Today's Canadian Franchise Lawyer – Practising Locally in a Global Industry: 7th Annual Franchise Law Conference, Ontario Bar Association, November 15, 2007) at 3, n.9 [Sotos and Trebilcock, "The (Material) Facts"].

[54] *Ibid*., n. 7.

> and lots of questions, and can meet with the franchisor's personnel to ask lots and lots of questions and judge their abilities. Second, the legal cost of preparing a prospectus for an initial public offering typically runs to hundreds of thousands of dollars. This would be prohibitively expensive for a franchise offering, since the proceeds of a typical franchise offering pale in comparison to the proceeds of a typical IPO.[55]

The definition adopted in the Model Bill and the P.E.I. and New Brunswick statutes offers more precision and certainty, and on balance, the Commission prefers this approach. Where more extensive disclosure is considered appropriate, it should be specified by regulation.

RECOMMENDATION 7

The Act should adopt the definitions of "material fact" and "material change" used in the ULCC Model Bill.

3. Disclosure Elements

In addition to the general requirement to disclose all material facts, all Acts require franchisors to provide specified material in the disclosure document. The information must be provided irrespective of whether it is, in the franchisor's opinion, material. The disclosure must be in a single document, delivered as one document at one time, and include the information required under the regulations.

The disclosure document must contain financial statements as prescribed, copies of all agreements relating to the franchise to be signed by the prospective franchisee, statements as prescribed for the purpose of assisting the prospective franchisee in making informed investment decisions and other information and copies of documents as prescribed.

The ULCC Model Regulation contains a more extensive and detailed list of information that must be disclosed than is required under provincial regulations. However, several disclosure requirements are generally consistent among the provincial regulations and the Model Regulation. The categories of disclosure that are generally consistent include:[56]

- the business background of the franchisor, and of the directors, officers and general partners of the franchisor;
- a statement indicating whether, during the preceding 10 years, the franchisor, the

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[55] Sotos and Trebilcock, "The (Material) Facts", *supra* note 53 at 14-15 (discussing whether a franchisor's legal counsel has an obligation to verify the accuracy and completeness of information in a disclosure document).

[56] See *ULCC Model Regulation*, *supra* note 18; *Alberta Regulation*, *supra* note 31; O. Reg. 581/00 [*Ontario Regulation*]; *Franchises Act Regulations*, P.E.I. Reg. EC232/06 [*P.E.I. Regulations*]. Regulations have not yet been made in New Brunswick. The disclosure requirements are summarized for the purposes of this report and variations in wording and requirements exist. In some cases, the time periods for which information must be provided are fiscal years rather than calendar years. See also Leblanc and Dillon, *supra* note 3, for a comprehensive comparison of the disclosure requirements of the Ontario, Alberta and P.E.I. Acts.

franchisor's associate or a director, general partner or officer of the franchisor has been charged with or convicted of fraud, unfair or deceptive business practices or a violation of a law that regulates franchises or business, including the details of the charge or conviction;[57]

- a statement indicating whether the franchisor, the franchisor's associate or a director, general partner or officer of the franchisor has been subject to an administrative order or penalty under a law that regulates franchises or business or is the subject of any pending actions, including the details;
- a statement indicating whether the franchisor, the franchisor's associate or a director, general partner or officer of the franchisor has been found liable or is the subject of a pending suit in a civil action of misrepresentation, unfair or deceptive business practices or violating a law that regulates franchises or business, including the details;
- the details of a bankruptcy or insolvency proceeding within the preceding 6 years involving the franchisor, the franchisor's associate or a director, general partner or officer of the franchisor;
- financial statements audited in accordance with the generally accepted accounting standards set out in the Canadian Institute of Chartered Accountants Handbook or prepared in accordance with generally accepted accounting principles and complying with the standards for review engagements in the Handbook (the accounting standards of other jurisdictions are acceptable so long as they meet the review standards);
- the costs of establishing the franchise and, if operating costs are provided, the supporting assumptions and information (in Alberta, the franchisor must provide details of the initial investment and the assumptions underlying any estimate of working capital);
- if the franchisor includes earnings projections, supporting assumptions and information for the projections;
- the extent to which the franchisee is required to participate personally in the operation of the franchise;
- contact information for current franchisees and former franchisees who ceased to operate a franchise during the previous fiscal year, and information as to the number of franchises that ceased operation during the previous three fiscal years;
- restrictions on suppliers, products or markets;
- a description of any rebates received by the franchisor and whether they are shared with franchisees;
- policies and practices respecting exclusive territories;
- restrictions in the franchise agreement on renewal, termination or transfer of the franchise;
- information about financing offered by the franchisor, and
- in jurisdictions other than Alberta, information about mandatory and optional training and advertising fund requirements.

As noted, the ULCC Model Regulation requires franchisors to provide more extensive disclosure than is required under the provincial regulations. In most cases, the Model Regulation

[57] The P.E.I. regulations require disclosure under these categories in respect of a law that regulates franchises (and not in respect of a law that regulates business): *P.E.I. Regulations*, *ibid.*

deals with matters addressed under most of the provincial regulations but requires more detail. For example, the provincial regulations require that where an estimate of operating costs is included, the assumptions for the estimate must be provided. They also require a description of any training provided to franchisees. The Model Regulation adds a requirement that where an estimate of costs is not included or a franchisor does not provide training, the disclosure document must include statements to that effect. Similarly, where franchisees are required to contribute to an advertising fund, provincial regulations require franchisors to provide a description of the fund and the amount or basis for calculating the amount of the franchisee's contribution. The Model Regulation requires more detailed disclosure in respect of advertising funds, including policies and practices for the expenditure of money from the fund, the portion of the fund that may be spent for franchisee recruitment and the availability of financial statements.

The Model Regulation also requires disclosure of some information that is not identified under the provincial regulations. For example, the Model Regulation requires a franchisor to provide a summary of the material topics covered in any manuals provided to the franchisee, or a statement specifying where the manuals are available for inspection (manuals may be incorporated by reference in a franchise agreement). If no manuals are provided, the franchisor must include a statement to that effect.

The approach taken under provincial regulations, where less detailed information is specifically required to be disclosed, may be less likely to result in irrelevant information being included in a disclosure document, and there is still a general requirement to include information about a matter that is not listed but meets the definition of "material fact". It is also the current Canadian standard. However, there is a risk that a franchisor may take the view that a relevant fact is not material, and exclude information that a franchisee would find influential.[58]

The P.E.I. Act and regulations are modeled after the ULCC Model Bill and Regulation but do not entirely adopt the ULCC detailed approach with respect to disclosure. The P.E.I. Office of the Attorney General commented on this choice in its Discussion Paper addressing the P.E.I. regulations:

> The ULCC regulations have been drafted to require extensive disclosure in all the listed areas whether or not the matter would be "material" to the franchisee in making the decision to sign the franchise agreement. The extensive list gives comfort to a franchisor that if they complete the document fully and honestly, they have almost certainly met the material fact disclosure requirement even though much of the disclosed information might not be material in a given situation.
>
> The PEI regulations have not fully adopted this approach. The PEI regulations have been drafted with an eye to the minimum standards which exist at present in the Canadian marketplace, i.e. the laws of Ontario and Alberta. Generally, matters which are not required to be disclosed or not required to be disclosed in the detail required by the ULCC regulations have not been included in the PEI regulations. These matters would only need to be included if they are "material". At the same time, there is nothing in the

[58] For example, Sotos and Trebilcock suggest that franchisors are required, under the obligation to disclose all material facts, to disclose more extensive information about pooled advertising funds than the Ontario regulations specify: Sotos and Trebilcock, "The (Material) Facts", *supra* note 53 at 5.

> PEI regulations which would restrict a franchisor from providing the full disclosure in the form of the ULCC regulations if they chose to do so.[59]

The consultation paper asked for comment as to which approach should be taken in Manitoba. Opinions on this point varied. One respondent commented:

> I would recommend the existing provincial approach to the disclosure of material facts… there is a never-ending list of items and categories that could be disclosed in a franchise disclosure document. However, the requirements of the existing provincial legislation targets the most important items requiring disclosure. I would not recommend extending the list for Manitoba at this time.[60]

Others supported the ULCC approach:

> The ULCC approach was based on the unanimous view of the Committee and the endorsement by the ULCC of the need for broad disclosure on a number of issues which typically are relevant and important to most franchises. Otherwise, disclosure of these particular matters will be left to the discretion of the franchisor based on the franchisor's analysis as to whether or not the information is considered material which, ultimately, is a factual determination. To deny the prospective franchisee disclosure on these critical issues may result in a minimalist approach to disclosure, while, on the other hand, mandating broad disclosure would at the very least ensure full disclosure of key business and legal issues in the system, which will be augmented by mandating the disclosure of all other "material facts". The requirement to disclose all other "material facts" is necessary as there are subjective facts in virtually every franchise system which will have relevance and importance to a prospective franchisee.[61]

Another respondent favoured a broad approach:

> When it comes to disclosure in franchise relationships, I am a firm believer in the maxim that "more is better than less". My suggested approach is that the Uniform Law Conference of Canada (ULCC) Draft Model Franchise Act approach to "material facts" be used, modified or qualified by the words "including, but not limited to", before the beginning of the list.[62]

Similarly, another submission commented:

> [S]ince the primary purpose of establishing franchise legislation is to protect franchisees and help in making the decision to purchase a franchise, the ULCC provisions should be adopted.[63]

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[59] P.E.I. Office of the Attorney General, *Franchises Act Regulations Discussion Paper* (October 19, 2005) at 1-2, online: <http://www.gov.pe.ca/photos/original/oag_franchiseac.pdf>.

[60] Submission by E. Levitt (July 19, 2007) at 2.

[61] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 4-5.

[62] Submission by A.L. Weinberg (July 18, 2007) at 5.

[63] Submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007) at 13.

In a report to the Ontario Government respecting the Ontario disclosure provisions, the Ontario Bar Association Joint Subcommittee on Franchising advocated greater precision to assist franchisors:

> In our view the disclosures required by O.Reg. 581/00 fall far, far short of the "all material facts" standard established by the Act, and as a consequence the Regulation poses a dangerous trap for the unwary.[64]

In general, the Commission is in favour of extensive pre-sale disclosure. We have carefully considered the disclosure requirements of the various provincial regulations and the ULCC Model Regulation, and are satisfied that the categories of information required to be disclosed in the ULCC Model Regulation represent matters that would be relevant to prospective franchisees in most cases and are reasonable and appropriate for Manitoba. While we recognize the valid interest in ensuring that franchisors are not discouraged from conducting business in Manitoba, we did not receive any submissions from franchisors opposing the ULCC approach, and in our view the ULCC requirements simply capture more accurately the information that a franchisor would be required to disclose as material facts in any event. In that light, more specific requirements provide more certainty, and as a result may benefit franchisors as well as franchisees.

The Commission recommends that Manitoba adopt the ULCC approach, subject to the modifications discussed below.[65]

RECOMMENDATION 8

Manitoba should make regulations adopting the ULCC Model Regulation approach to disclosure, subject to the specific modifications noted below.

(a) Business Background

i) Individuals With Management Responsibility

Paragraph 3(b) of the Model Regulation requires information to be disclosed about the business background of the franchisor and of the directors, general partners and officers of the franchisor. The Ontario regulation has a similar provision. The Alberta and P.E.I. regulations are more narrow, requiring the disclosure of the business background of the franchisor and those directors, general partners and officers who will have day to day management responsibilities relating to the franchise.

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[64] OBA Joint Subcommittee on Franchising, *supra* note 20, Executive Summary.

[65] While it is not possible to address this issue in detail for the purposes of this report, we note that the Ontario Bar Association Joint Subcommittee on Franchising recommendations for amendments to the Ontario regulation include a number of explanatory sections and plain language improvements to the content and style of the Ontario regulation (many based on the amended U.S. FTC Rule), some of which could be adapted for Manitoba: *ibid*.

Like the Model Regulation, the amended U.S. FTC Rule requires the disclosure of background information of a franchisor's directors and executives. However, the Rule also requires disclosure in respect of any other individuals, regardless of title, who will have management responsibility relating to the sale or operation of franchises, to ensure that "franchisors cannot conceal a manager's lack of experience, prior litigation or bankruptcy history by simply avoiding giving the manager a formal title".[66] Similarly, the recent amendments to the Australian Franchising Code of Conduct have broadened the business background disclosure requirements to "officers", which is defined to include any persons who participate in making decisions that affect a substantial part of the business of the franchisor.[67] The Ontario Bar Association Joint Subcommittee on Franchising also recommended disclosure in respect of any person who has management responsibility relating to the sale or operation of the franchise.[68]

The Commission agrees that the central issue is not the title that an individual holds, but his or her actual role within the franchise system. Business background disclosure should be required with respect to all those who exercise management responsibilities relating to the sale or operation of the franchise.

RECOMMENDATION 9

The regulations should require, in addition to the requirements in the ULCC Model Regulation, disclosure of the business background of any individual who will have management responsibilities relating to the sale or operation of the franchise.

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[66] U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15476.

[67] *Corporations Act 2001* (Cth.), s. 9.

[68] OBA Joint Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 11. The approach of the Ontario Bar Association Joint Subcommittee on Franchising of defining a "disclosable person" for the purposes of the various disclosure obligations in the regulation helps to set these obligations out clearly. The Commission notes that one submission recommended that disclosure not be required in relation to officers, directors and partners with management responsibilities, unless there is a clear and meaningful definition of "management responsibilities": submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007). In this regard, the definition of "officer of a corporation" in the Australian *Corporations Act 2001*, *ibid*., may provide a model. The *Corporations Act 2001* definition identifies specific positions, and includes "a person (i) who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; or (ii) who has the capacity to affect significantly the corporation's financial standing; or (iii) in accordance with whose instructions or wishes the directors of the corporation are accustomed to act (excluding advice given by the person in the proper performance of functions attaching to the person's professional capacity or their business relationship with the directors or the corporation". On the other hand, "management responsibility" is not defined in the FTC Franchise Rule or in the amendments proposed by the OBA Joint Subcommittee on Franchising.

(ii) Franchisor's Associate/Affiliate

In the ULCC Model Bill, "franchisor's associate" is defined as a person who directly or indirectly controls or is controlled by the franchisor or is controlled by another person who controls the franchisor, and who is directly involved in the grant of the franchise, or who exercises significant operational control over the franchisee and to whom the franchisee has a continuing financial obligation. "Affiliate" is defined in the ULCC Model Regulation to have the same meaning as in the *Canada Business Corporations Act*,[69] which sets out a relationship of control similar to that of a franchisor's associate – a relationship in which one person controls or is controlled by another person or both are controlled by a third person. No direct involvement in the franchise is required.

The Model Regulation requires disclosure of the business background of the franchisor and of the directors, general partners and officers of the franchisor, but does not require disclosure of the business background of the franchisor's associate or affiliates or their directors, general partners or officers. With respect to legal history, disclosure is required of any convictions, administrative orders and civil actions involving a franchisor's associate, but not those involving an affiliate.

The amended FTC Rule requires disclosure of the prior business experience of franchisor affiliates that offer franchises in any line of business or provide products or services to the franchisees of the franchisor.[70] The amended Australian Franchising Code of Conduct requires that financial reports be provided on request for any consolidated entity to which the franchisor belongs.[71]

The Ontario Bar Association Joint Subcommittee on Franchising recommended that disclosure of business background information be extended to affiliates of the franchisor (which would include franchisor's associates) and to an affiliate's directors, officers and general partners. Opposition to this concept was expressed by some respondents to the consultation paper.[72] On balance, the Commission is persuaded that the level of disclosure suggested by the Joint Subcommittee is justified. Franchisor's associates and affiliates are significantly connected to the franchisor through relationships of control, and the use of a variety of corporate structures could present significant opportunities for franchisors to avoid disclosing background information that would be relevant to a prospective franchisee. In the Commission's view, a disclosure requirement is appropriate.

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[69] R.S. 1985, c. C-44, s. 2.

[70] *FTC Franchise Rule*, *supra* note 26, 16 C.F.R. § 436.5(a)(7). "Affiliate" is defined as an entity controlled by, controlling, or under common control with, another entity: 16 C.F.R. § 436.1(b).

[71] *Trade Practices (Industry Codes – Franchising) Regulations 1998* (Cth.), Sch.., Annexure 1, s. 20.2 [*Franchising Code of Conduct*].

[72] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007): the authors recommended that disclosure not be required in respect of the parents, predecessors, affiliates or associates of a franchisor unless they constitute "franchisor's associates".

RECOMMENDATION 10

The regulations should require disclosure of the business background of a franchisor's associate and affiliate and of a director, general partner or officer of a franchisor's associate or affiliate.

(iii) Franchisor's Broker

The ULCC Model Bill defines "franchisor's broker" as a person other than the franchisor, franchisor's associate or franchisee who grants, markets or otherwise offers to grant a franchise, or who arranges for the grant of a franchise.

The Model Regulation does not require disclosure of the business background of a franchisor's broker. The Ontario Bar Association Joint Subcommittee on Franchising recommended that disclosure be required in respect of a franchisor's broker and a current director, officer or general partner of the broker, as well as in respect of any other person "who makes representations on behalf of the franchisor directly to the prospective franchisee for the purpose of granting, marketing or otherwise offering to grant the franchise".[73]

In the U.S., the UFOC Guidelines had required that franchisors identify all brokers, but the amended FTC Rule does not include this requirement. The FTC received submissions in favour of the requirement, stating that prospective franchisees often perceive brokers as being independent, third-party experts and rely on statements made by them, and that listing brokers in a disclosure document would make it clear that brokers act on behalf of the franchisor. However, the FTC held the view that, given that brokers do not set franchise policy, "the counteractive effect of the disclosure document gives the Commission reason to doubt that the inclusion of broker information … would yield more than a scant benefit to prospective franchisees. Further, the disclosure of brokers would also be cumbersome, especially for large franchise systems that may employ hundreds of brokers nationally".[74]

In the Commission's view, the reasoning of the FTC is persuasive, given that the long term relationship is between the franchisor and franchisee, and the burden associated with a requirement to disclose background information in respect of all brokers or other persons making representations in relation to the sale of a franchise would outweigh the benefits that may result.

RECOMMENDATION 11

The regulations should not require disclosure of the business background of a franchisor's broker or other person making representations for the purpose of granting or marketing a franchise.

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[73] OBA Joint Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 11.

[74] U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15476.

(iv) Franchisor's Predecessor

The amended FTC Rule requires that franchisors must disclose business background, litigation and bankruptcy information about their predecessors for the 10 year period immediately before the close of the franchisor's most recent fiscal year. The intent of the disclosure is to "prevent unscrupulous franchisors from hiding prior misconduct and avoiding disclosure obligations simply by assuming a new corporate identity".[75] This requirement had existed in the UFOC Guidelines, and according to the FTC, no one objected to the principle that predecessor information should be disclosed.[76]

Canadian franchisors have also apparently avoided disclosure obligations through the assumption of new corporate identities. As outlined in the section on franchisor exemptions later in this report, "[t]o avoid disclosing the financial statements of their operating companies, many franchisors incorporate sparsely detailed separate companies solely to act as the "franchisor" in a franchise relationship".[77] The Ontario Bar Association Joint Subcommittee on Franchising recommended that the scope of business background disclosure in Ontario be expanded to include predecessors of the franchisor, to "prevent franchisors from hiding previous misconduct and otherwise avoiding unfavorable disclosure simply by assuming a new identity".[78]

In the Commission's opinion, disclosure of information about corporate predecessors would help to ensure that full and accurate information relevant to the decision to acquire the franchise is available to prospective franchisees. The Joint Subcommittee's suggested definition of "predecessor" is helpful in this context (a person from whom the franchisor acquired the majority of its business assets within the previous five years), although the Commission prefers that a 10 year period be used for the purpose of identifying who is a predecessor.

RECOMMENDATION 12

The regulations should require disclosure of the business background of a franchisor's predecessor and its directors, general partners and officers. A franchisor's predecessor is a person from whom the franchisor directly or indirectly acquired the majority of the franchisor's business assets in a transaction or a series of transactions partly or wholly completed within the 10 years immediately preceding the date of disclosure.

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[75] *Ibid*. at 15474.

[76] *Ibid*. at 15475.

[77] Jones and So, *supra* note 24 at 34.

[78] OBA Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 2.

(b) Charges, Convictions, Administrative Orders and Civil Actions

Paragraph 3(c) of the Model Regulation requires disclosure of charges or convictions relating to the franchisor, the franchisor's associate, or a director, general partner or officer of the franchisor, in respect of fraud and unfair practices or a law that regulates franchises or businesses during the 10 years immediately before the date of the disclosure. Paragraph 3(d) requires information to be disclosed as to whether the franchisor, the franchisor's associate or a director, general partner or officer of the franchisor has been subject to an administrative order or penalty under a law that regulates franchises or business or whether the person is the subject of any pending action. Paragraph 3(e) requires disclosure in respect of a finding of liability in a civil action or a pending civil action in relation to misrepresentation, unfair or deceptive business practices or a violation of a law that regulates franchises or business. Paragraph 3(f) requires disclosure of bankruptcy or insolvency proceedings during the six years immediately before the date of disclosure.

The Commission considers that the regulations should require disclosure of the above charges, convictions, administrative orders, findings of civil liability and bankruptcies in respect of the same persons for whom disclosure of business background information is required.[79] Where a pardon has been granted in respect of a conviction, disclosure should not be required.

The Ontario Bar Association Joint Subcommittee on Franchising also recommended the disclosure of any settlements of civil proceedings on terms that were materially adverse to the person, along with a concise description of the details (including the material terms of settlement).[80] Similarly, the revised FTC Rule requires the disclosure of settled actions, including the settlement terms, unless the settlement is favourable or neutral to the franchisor.[81] One submission to the Commission opposed the disclosure of settled litigation and terms of settlement, unless otherwise available in a public forum, because of the information's confidential nature.[82] This point was considered by the FTC, who nevertheless implemented mandatory disclosure, noting that "franchisors using the UFOC Guidelines format have been living under this policy on the state level for more than 10 years, apparently without much hardship".[83] The Commission agrees that the disclosure of materially adverse settlements of the types of civil proceedings described above is consistent in principle with the objectives of franchise legislation, and would make it more difficult for franchisors to avoid the disclosure of matters relating to practices such as misrepresentation or fraud. Otherwise, a significant gap in

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[79] Ontario Bar Association Joint Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 11.

[80] *Ibid*; the Joint Subcommittee recommendations also improve and refine the disclosure requirement, requiring disclosure in respect of "a civil proceeding involving an allegation against that person of misrepresentation, unfair or deceptive business practices, violating a law that regulates franchises or securities, or materially violating a law that regulates business, including failure to provide proper disclosure to a prospective franchisee".

[81] U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15479; 16 C.F.R. § 436.5(c)(1)(iii)(B). A transitional period is allowed for confidential settlements entered into before the franchisor commenced franchise sales or, for certain franchisors, entered into before the effective date of the Rule.

[82] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007).

[83] U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15479.

the disclosure requirements would exist.

Paragraph 3(c) of the Model Regulation, which requires disclosure of convictions or charges relating to fraud and unfair practices, limits the time period for which disclosure is required to the previous 10 years. No time period is specified for the disclosure of information relating to administrative or civil actions. The Commission sees no reason to limit the time period in respect of convictions but not for administrative orders or civil actions. In our view, a 10 year period constitutes effective disclosure.

RECOMMENDATION 13

The regulations should require disclosure, with a concise description of details, of previous convictions in respect of which no pardon has been granted, administrative orders and penalties, findings of liability, settlements of civil proceedings on materially adverse terms (including the material terms) and bankruptcies in respect of:

- ***the franchisor and its associates, affiliates and predecessors;***
- ***the directors, general partners and officers of the franchisor and its associates, affiliates and predecessors; and***
- ***any individual who will have management responsibilities relating to the sale or operation of the franchise.***

RECOMMENDATION 14

The regulations should limit the time period for which disclosure is required in respect of administrative orders and civil actions to the 10 year period immediately before the date of disclosure.

(c) Recurring Fees and Payments

Paragraph 4(1)(b) of the Model Regulation and section 7 of the Alberta regulation require franchisors to disclose the nature and amount of any recurring or isolated fees or payments, other than the list of costs already set out in the regulation, that the franchisee must pay to the franchisor or franchisor's associate or that the franchisor or its associate collects on behalf of a third party. The P.E.I. regulations have a similar requirement but provide an exception for payments required to be collected by law on behalf of a municipal, provincial or federal government. According to the P.E.I. Office of the Attorney General, this exception was suggested during the consultations on their draft regulations.[84]

[84] Email correspondence from Katharine Tummon, Director of Consumer, Corporate and Insurance Services, Office of the Attorney General, P.E.I. (January 18, 2008).

The Ontario regulation does not require the franchisor to disclose continuing payments that the franchisee must pay to the franchisor. The Ontario Bar Association Joint Subcommittee on Franchising has recommended that the regulation be amended to require disclosure of all fees and payments that the franchisee must pay to the franchisor or its affiliate while operating the franchise business or that the franchisor or its affiliate imposes or collects on behalf of a third person.[85]

The Commission agrees that disclosure should be required of payments required to be made to the franchisor, its associate or affiliate. An exception for payments that are not unique to the franchise and that the franchisor is required to collect on behalf of government, such as tax payments, is reasonable. The disclosure document should include a statement advising franchisees that additional payments may be required by law to be collected on behalf of government.

RECOMMENDATION 15

The regulations should require disclosure of all fees and payments that the franchisee must pay to the franchisor or its associate or affiliate, with the exception of payments required to be collected by law on behalf of a municipal or provincial government or the federal government. The regulations should also require that the disclosure document include a statement advising franchisees that the franchisor may be required by law to collect additional payments on behalf of a municipal or provincial government or the federal government.

(d) Financial Performance Representations

The ULCC Model Regulation and the P.E.I. regulations currently require a franchisor that provides an estimate of operating costs or an earnings projection to include additional information, including the assumptions and bases underlying the estimate or projection, a statement that the assumptions and bases are reasonable. The disclosure must identify where information to substantiate the projection is available for inspection. A franchisor must also state whether an earnings projection is based on actual results of existing franchises and if so, those locations or markets. Where the projection is based on a business operated by the franchisor, the disclosure must state that the information may differ in respect of a franchise operated by a franchisee.

Recent amendments to the Manitoba *Securities Act*[86] and to other Canadian securities statutes address estimates of future results. The amendments provide a defence to an action for misrepresentation in forward-looking information, which is defined broadly:

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[85] OBA Joint Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 21. This is similar to the requirement under the FTC Rule: *FTC Franchise Rule*, *supra* note 26, 16 C.F.R. § 436.5(f).

[86] *Supra* note 40.

> "forward-looking information" means disclosure regarding possible events, conditions or results of operations that is based on assumptions about future economic conditions and courses of action, and includes future-oriented financial information with respect to prospective results of operations, financial position or cash flows that is presented either as a forecast or a projection.[87]

The amendments provide a defence to an action for misrepresentation in forward-looking information if the document containing the information contained, proximate to the information, a statement of the material factors or assumptions applied, and reasonable cautionary language identifying the forward-looking information as such and identifying the material factors that could cause actual results to differ materially. The person or company must also have had a reasonable basis for drawing the conclusions or making the forecasts or projections.[88]

The Ontario Bar Association Joint Subcommittee on Franchising also made several recommendations with respect to the Ontario regulation aimed at increasing the level of disclosure in relation to financial performance representation. The recommendations rely on securities legislation concepts and U.S. experience. Among these is the recommendation that where a financial performance representation is based on the actual experience of existing franchises or businesses of the franchisor or the franchisor's associate or affiliate, the disclosure must include the percentage of each type of unit that achieved the results and state that results of a specific unit may vary. Where the representation is based on the experience of a subgroup of units, the disclosure must include the nature and number of units forming the subgroup, the basis for selecting them and any characteristics of the units that may differ materially from the franchise unit being offered. If the representation is based on businesses operated by the franchisor or the franchisor's associate or affiliate, the disclosure must state reasonable details of the adjustments necessary to make the information relevant to franchised units. These recommendations are similar to provisions in the amended FTC Rule.[89]

The Commission supports the requirements of the ULCC Model Regulation and the P.E.I. regulations. However, the requirements could be refined further to provide clearer protection to franchisees. The Commission recommends the franchisor also be required to include reasonable cautionary language with respect to the forward-looking nature of the information, and to identify the material factors that could cause actual results to differ materially. Where relevant, disclosure should be required with respect to the actual experience of units on which the representation is based. The Commission notes that the broader term "financial performance representation", used by the FTC and the Ontario Bar Association Joint Subcommittee, may be preferable to "earnings projection", as it recognizes that there are variables other than earnings that are used in various industries to measure and communicate performance.[90]

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[87] *The Securities Act, ibid.*, s. 1(1), as am. by *The Securities Amendment Act*, S.M. 2007, c. 12, s. 2(1).

[88] *The Securities Act, ibid.*, s. 141.1.2, as am. by *The Securities Amendment Act, ibid.*, s. 41.

[89] U.S. Federal Trade Commission, *Final Rule, supra* note 29 at 15499.

[90] For example, the hotel industry may measure factors such as room occupancy rates: U.S. Federal Trade Commission, *Final Rule, supra* note 29 at 15456, n. 97.

RECOMMENDATION 16

The regulations should provide that where a financial performance representation is included in the disclosure document, the document must contain, in addition to the information identified in the ULCC Model Regulation, reasonable cautionary language respecting the forward-looking nature of the information and identifying the material factors that could cause actual results to differ materially.

RECOMMENDATION 17

The regulations should provide that:

- ***where a projection or forecast of financial performance is based on the actual experience of existing franchises or businesses of the franchisor or its associate or affiliate, the disclosure must include the percentage of each type of unit that achieved the results and state that results of a specific unit may vary;***
- ***where a projection or forecast of financial performance is based on the experience of a subgroup of units, the disclosure must include the nature and number of units forming the subgroup, the basis for selecting them and any characteristics of the units that may differ materially from the franchise unit being offered; and***
- ***where a projection or forecast of financial performance is based on businesses operated by the franchisor or its associate or affiliate, the disclosure must include reasonable details of the adjustments necessary to make the information relevant to franchised units.***

The amended FTC Rule and the Ontario Bar Association Joint Subcommittee on Franchising recommendations also address more clearly how representations about future earnings may be made. They provide that a financial performance representation need not be made, but if one is made, it must be included in one place in the disclosure document (or supplemental performance statement), along with the supporting information described above. A franchisor that chooses not to include a representation in these documents must include a standard statement that it does not make or authorize anyone else to make representations about future or past financial performance of franchises of the type being offered or businesses using the same trade name. The Joint Subcommittee recommendation adds a statement that if the prospective franchisee acquires a franchise of the type being offered, the franchisee's actual results will vary depending on location and other factors that the franchisor cannot reasonably estimate or predict.

The Joint Subcommittee explains that the requirement for a statement that the franchisor does not make or authorize anyone else to make performance representations "is intended to make it more difficult for a franchisor to make an under the table (unregulated) financial

performance representation in connection with offering the franchise".[91] The FTC notes that its "law enforcement experience and the record show that franchisors often state in their disclosure document that they do not furnish financial performance claims, yet give prospective franchisees false or misleading financial performance data outside of the disclosure document".[92] While including these requirements will not deter those intent on misleading prospective franchisees or committing fraud, the provisions may help to alert franchisees to the need for caution in the circumstances.

RECOMMENDATION 18

The regulations should provide that:

- ***where a projection or forecast of financial performance is made, it must be included in one place in the disclosure document, along with the supporting information required by the regulations;***
- ***where a projection or forecast of financial performance is not included in the disclosure document, the disclosure document must include a standard statement that:***
  - ***the franchisor does not make or authorize anyone else to make projections or forecasts of financial performance;***
  - ***if the franchisee acquires a franchise of the type being offered, the results will vary depending on location and other factors.***

(e) Rebates, Commissions and Benefits

Rebates and other benefits provided to franchisors, particularly hidden rebates, are a consistent source of concern identified in reports of franchisor-franchisee disputes, and franchisees frequently advocate more extensive disclosure. One respondent explained the rationale in support of greater disclosure of sources of supply and competitive prices:

> Many franchise agreements require their franchisees to purchase products from the franchisor or supplier designated by the franchisor ("designated supplier"). In some circumstances, the franchisor has an ownership interest in the designated supplier, or receives a kick-back or hidden profits on sales made by the designated supplier to the franchisees. Without disclosure legislation requiring a franchisor to disclose these arrangements, the franchisee does not really know how much he or she is paying to the franchisor for the right to be part of the franchise chain. The franchisee knows what its royalty contributions are, what its advertising payments are, but does not know what the mark-up and/or kick-back to the franchisor is, which is also a cost of being part of the

[91] OBA Joint Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 46.

[92] U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15531. The statement required under the revised FTC Rule informs prospective franchisees that if financial performance information is not included in the disclosure document, they should report any financial performance representations made or provided (other than actual records of an existing outlet being purchased) to the franchisor's management, the FTC or a state regulatory agency: *FTC Franchise Rule*, *supra* note 26, 16 C.F.R. § 436.5(s)(2).

franchise chain.[93]

In Australia, the recent amendments to the Franchising Code require disclosure of the name of the party from whom the franchisor or its associate receives rebates or financial benefits.[94] The revised FTC Rule requires detailed rebate disclosure, including the basis for calculating payments to the franchisor from suppliers that franchisees are required to use, and the identity of any supplier in which an officer of the franchisor has an interest.[95]

In Canada, the ULCC Model Regulation requires more extensive disclosure than currently exists under provincial regulations. The Model Regulation requires franchisors to provide a description of the franchisor's policies and practices regarding rebates, commissions or other benefits, including the receipt by the franchisor or franchisor's associate of a benefit as a result of purchases of goods and services by franchisees and a description of how benefits may be shared with franchisees, either directly or indirectly. The Ontario Bar Association Joint Subcommittee on Franchising has recommended amendments for Ontario that would be similar to the Model Regulation. However, the proposed amendments are also intended to prevent the standard disclosure practice of some franchisors to state that they have 'no rebates policy'. The proposed amendments would require disclosure of whether the franchisor or any franchisor's affiliate received rebates or benefits in the most recent fiscal year, whether the rebates or benefits formed a material part of the total revenue of the recipient for that year, whether and how any rebates and benefits were shared with any franchisees, and whether the franchisor or affiliate receives or may receive benefits during its current fiscal year. As well, the proposed amendments recognize that rebates and other benefits may be available for reasons other than purchases, such as lease inducements, for example.[96]

The ULCC Model Regulation ensures that a prospective franchisee will be informed of the existence of rebates and benefits. While methods of calculation may change, the fact that the franchisor is in a position to receive such benefits is the information that is critical for franchisees. The Commission supports the ULCC approach, with the refinements suggested by the Ontario Bar Association.

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[93] Submission by A.L. Weinberg (July 18, 2007) at 8.

[94] *Franchising Code of Conduct*, *supra* note 71, Sch., Annexure 1, s. 9.1.

[95] *FTC Franchise Rule*, *supra* note 26, 16 C.F.R. § 436.5(h).

[96] OBA Joint Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 26-27. Similarly, Sotos and Trebilcock recommend that "a franchisor who proposes to retain for itself some or all of these rebates ought also disclose whether or not they amount to a significant portion of the franchisor's total revenue stream": John Sotos and Arthur J. Trebilcock "Canadian Franchise Disclosure Statutes: Disclosure of Rebates – Recommendations" (Paper submitted to the 2008 Franchise Law Symposium, Marcel A. Desautels Centre for Private Enterprise and the Law and Asper Chair of International Business and Trade Law, March 14, 2008) at 3. The authors recommend disclosure of volume rebates revenue as a percentage of total revenue of the franchisor or an affiliate of the franchisor where that percentage exceeds 5% for two fiscal years.

RECOMMENDATION 19

The regulations should require disclosure of information respecting rebates as set out in the ULCC Model Regulation, requiring franchisors to provide a description of their policies and practices regarding rebates, commissions or other benefits. The regulations should also require disclosure of whether the franchisor or any affiliate of the franchisor received rebates or benefits in the most recent fiscal year, whether the rebates or benefits formed a material part of the total revenue of the recipient for that year and whether and how any rebates and benefits were shared with any franchisees.

(f) Territories and Encroachment

The ULCC Model Regulation requires franchisors to disclose their policies and practices, if any, regarding franchise territories, including the granting and modification of territories, rights of first refusal and the granting of exclusive territories. Franchisors must also describe their policies and practices with respect to the proximity between an existing franchise and other franchises of the system or other businesses operated by the franchisor.[97]

The Model Regulation includes a greater level of detail than the Ontario regulation, and the Ontario Bar Association Joint Subcommittee on Franchising has noted that its members were aware of

> numerous continuing franchisee complaints about franchisor "encroachment": a series of practices by which a franchisor competes, directly or indirectly, with its own franchisees or "cannibalizes" its franchisees' market share. For example, a franchisor may establish franchisor-owned units or new franchised units in "close proximity" (i.e. competing for the same customers) to existing franchised units, or may sell the same goods and services through alternative channels of distribution, or may acquire and operate a competing franchise system within the same or [a] contiguous market area.

The Joint Subcommittee recommended several amendments to the Ontario regulation in relation to exclusive territories, some of which are not contained in the Model Regulation. These included a recommendation that where the franchisee is not granted any exclusive territory, the franchisor be required to include an express statement to that effect, with warnings that the franchisee may face competition from other franchisees or licensees, from units owned by the franchisor or an affiliate or from other channels of distribution or competitive brands of the franchisor or an affiliate (the FTC Rule contains a similar requirement and warning). As well, where a franchisee is granted an exclusive territory, the Joint Subcommittee recommended that

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[97] The Ontario Court of Appeal in *Shelanu* noted the similar Ontario provisions, and quoted from Hoffman that in the absence of such disclosure, "... there is an expectation on the part of the franchisee that the franchisor will not establish a corporate or franchise location (or another business [or] channel of distribution) within such proximity or in such a manner that would negatively [affect] the franchisee's business: *Shelanu Inc. v. Print Three Franchising Corp.* (2003), 64 O.R. (3d) 533, n. 1 (C.A.) [*Shelanu*], quoting Jeffrey P. Hoffman, "Statutory Obligations of Fair Dealing and Good Faith in Canada" (2nd Annual Franchise Law Conference: A New Act, A New Era of Disclosure - One Year Later, Ontario Bar Association C.L.E., 22 February 2002) at 22.

the franchisor be required to disclose the boundaries of the territory, or describe who will determine them and how they will be determined.

Some respondents to the consultation paper also expressed support for more detailed provisions requiring franchisors to disclose information as to how they may compete with franchisees through alternative distribution channels such as internet and catalogue sales.[98] The recent amendments to the FTC Rule require disclosure about whether the franchisor has used or reserves the right to use alternative distribution channels, "to address new technologies and market developments".[99]

The Commission agrees with these suggestions.

RECOMMENDATION 20

The regulations should require, in addition to the requirements of the ULCC Model Regulation,

- ***where a franchisee is granted an exclusive territory, disclosure of the boundaries of the territory or a description of who will determine the boundaries and how they will be determined;***
- ***disclosure of the franchisor's policies and practices respecting the use by the franchisor and franchisees of alternative channels of distribution, such as the internet, catalogue sales, telemarketing or other direct marketing techniques, including disclosure with respect to whether the franchisor uses or reserves the right to use alternative distribution channels;***
- ***where the franchisee is not granted an exclusive territory, the inclusion of a express statement to that effect, with warnings that the franchisee may face competition from other franchisees, licensees or affiliates, from units owned by the franchisor or an affiliate or from other franchisor or affiliate channels of distribution or competitive brands.***

(g) Licences and Registrations

Paragraph 4(1)(w) of the ULCC Model Regulation requires a disclosure document to describe every licence, registration, authorization or other permission the franchisee is required to obtain under federal or provincial law or municipal by-law to operate the franchise. It was suggested to the Commission that this broad requirement is not practical given the plethora of licences and authorizations applicable to any business, and that Manitoba regulations should require a description of only those material licences, registrations and authorizations that are

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[98] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007); submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007). Concerns about franchisor competition through corporate internet sales were also raised by A. Donald: submission by A. Donald (August 19, 2007).

[99] U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15491.

specific to the franchise operation.[100] Similarly, the amended FTC Rule requires franchisors to disclose any laws or regulations specific to the industry in which the franchise business operates, "such as any necessary licenses or permits, that may affect the franchisee's operating costs and ability to conduct business".[101]

The Ontario Bar Association Joint Subcommittee on Franchising recommended that the Ontario regulations be amended to require a description of "any laws and regulations that apply to the industry in which the franchisee will conduct business through the franchise agreement, and that are material to that business, other than laws or regulations that apply to business generally".[102] The Subcommittee held the view that it isn't necessary to disclose the licences that are required by those laws or regulations that apply generally to all businesses.

The Commission agrees that requirements that are generally applicable to businesses need not be included in a disclosure document (for example the requirement to register to collect and remit GST). However, licences, registrations and authorizations or laws and regulations that relate to the specific type of franchise operation (such as food handling permits, for example) should be required to be disclosed. As well, the regulations should require the disclosure statement to advise that additional licences, registrations and authorizations other than those identified may be required and that additional laws applying generally to businesses may apply.

RECOMMENDATION 21

The regulations should require disclosure of those material licences, registrations and authorizations, and laws and regulations, that are specific to the type of business carried on by the franchise system. The regulations should also require that a statement be included in the disclosure document advising franchisees that additional licences, registrations and authorizations other than those identified may be required and that additional laws applying generally to businesses may apply.

(h) Renewal Provisions

Paragraph 4(1)(y) of the ULCC Model Regulation requires a franchisor to describe the provisions in the franchise agreement that deal with the termination and renewal of the agreement and the transfer of the franchise, and to list where the provisions are found in the

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[100] Submission by TDL Group Corp. (Tim Hortons) (July 31, 2007). Zaid notes, as well, that "[t]his disclosure item will force the franchisor to ensure that it has properly researched all licences, registrations, authorizations, or other permissions required under all local by-laws, which, in certain cases, may impose a considerable burden on the franchisor (e.g., municipal business licences, signage by-laws, environmental permits, and registration as a steward under the *Waste Diversion Act*)": Zaid, *Franchise Law*, *supra* note 25 at 97.

[101] U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15474; *FTC Franchise Rule*, *supra* note 26, 16 C.F.R. § 436.5(a)(6)(v).

[102] OBA Joint Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 7.

agreement.

The Commission notes, however, that where a franchise agreement does not contain an option for a franchisee to renew the agreement at the end of its term, Ontario courts have held that the duty of good faith does not require a franchisor to renew a franchise agreement.[103] Later in this report, the Commission makes recommendations respecting the right of a franchisee to renew a franchise agreement. The Commission also considers that it would be preferable to require that where a franchise agreement contains no specific right or option to renew, the franchisor must include a statement to that effect.

RECOMMENDATION 22

The regulations should require that, where a franchise agreement contains no right or option to renew the agreement, the disclosure document must include a statement to that effect.

(i) Schedules of Franchises and Franchisees

Paragraph 4(1)(z) of the ULCC Model Regulation requires schedules to be attached to the disclosure document. The schedules must contain contact information for other franchisees and for businesses of the same type as the franchise being offered that are being operated by the franchisor or its associates or affiliates, as well as contact information for former franchisees and businesses that ceased franchising or operating within the previous year. As well, a schedule of franchise and business closure information must be included that contains, in respect of the previous three years, the number of franchises that ceased operating for various reasons or were transferred, and the number of businesses of the same type operated by the franchisor or its associates or affiliates that ceased operation.

The Model Regulation sets out geographic rules for determining when contact information must be provided. The contact information for current franchisees must be provided for all franchisees in Canada, or if there are fewer than 20 in Canada, for all franchisees in Canada and the U.S. If there are still fewer than 20 franchisees, contact information must be provided for franchisees in the next country with the largest number of franchisees, and so on. The contact information for current franchisor businesses must be provided for all businesses operating in Canada. The contact information for former franchisees and businesses, and the information respecting the number of franchises and businesses that have ceased operating, must be provided in respect of Canada and any other country included under the above rules.

Provincial regulations require similar but more limited information to be provided. Contact information for franchisees is to be provided first on a provincial or regional basis and then more broadly until information for 20 franchisees has been provided. Contact information

[103] *530888 Ontario Ltd. v. Sobeys Inc*. (2001), 12 B.L.R. (3d) 267 (Ont. S.C.J.); *TDL Group Ltd. v. 1060284 Ontario Ltd*. (2000), 6 B.L.R. (3d) 54 (Ont. S.C.J.). In *TDL Group Ltd*., the franchisor was not required to provide a reason for declining to renew a 10 year franchise agreement in the absence of a renewal provision.

for former franchisees is also more limited; the Ontario regulation provides that contact information for former franchisees must be provided only for franchises that were located in Ontario, and the P.E.I. regulations require contact information for former franchisees of franchises in P.E.I., New Brunswick or Nova Scotia.

The Commission agrees that contact information for current and former franchisees is crucial information for a prospective franchisee. The Commission has considered the requirements of the Model Regulation and the provincial regulations and, while we agree with the general approach, we recommend some changes for Manitoba. In some circumstances, a prospective franchisee in Manitoba may be more interested in the experience of franchisees located in another province than in the experience of those in Manitoba. For example, a franchisee considering the purchase of a franchise located close to the Saskatchewan border may find information about a nearby Saskatchewan territory more relevant than information about the experience of Winnipeg franchisees. In the Commission's view, a franchisee should be entitled to contact information for all Manitoba franchisees, as well as for franchisees located outside Manitoba who are geographically close to the franchise being offered.

The Commission agrees with the approach taken in the Model Regulation that information respecting former franchisees and franchises that have ceased operations should not be limited to Canada. U.S. franchisors are increasingly showing interest in expanding to Canadian markets. A prospective Canadian franchisee should not be barred from contacting former franchisees simply because few yet exist in Canada; the franchisor may have significant experience in the U.S. and the franchisee may find the experience of former U.S. franchisees (in North Dakota, for example) to be illuminating.

The Ontario Bar Association Joint Subcommittee on Franchising also recommended amendments to the Ontario regulation to provide more detail in respect of unit and franchisee information. Among other things, the Subcommittee recommended that the disclosure include an estimate of the number of franchisor owned and franchised units that will be established or granted in the province, and the number that will open for business, in the 12 months following the disclosure. The Subcommittee also recommended the use of tables for the disclosure of certain information, as is required under the amended FTC Rule.[104] The tables would provide information for the last three fiscal years respecting the number of units that were operating in Canada and the U.S. at the beginning of each year and the number that opened, were transferred or ceased operating each year.[105] Those that ceased operating would be classified by the reason (e.g. franchisor termination, franchisee refusal to renew, mutual agreement, etc.), as is currently required under the Model Regulation. The Commission agrees that the proposed tables would provide easy to read snapshots of important information about the franchise for the prospective franchisee.

The Commission considers that the following requirements would be appropriate for Manitoba:

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[104] *FTC Franchise Rule*, *supra* note 26, 16 C.F.R. § 436.5(t).

[105] OBA Joint Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 30-33.

RECOMMENDATION 23

The regulations should require that disclosure include:

- ***contact information for***
  - ***all current Manitoba franchisees,***
  - ***the 20 current franchisees that are geographically closest to the unit being offered,***
  - ***all former franchisees that ceased operating in Canada within the previous year,***
  - ***the 20 former franchisees that ceased operating within the previous year that are geographically closest to the unit being offered,***
  - ***all current businesses of the same type as the unit being offered operated in Canada by the franchisor or its associate or affiliate,***
  - ***the 20 current businesses of the same type as the unit being offered operated by the franchisor or its associate or affiliate that are geographically closest to the unit,***
  - ***all former businesses of the same type as the unit being offered operated by the franchisor or its associate or affiliate that ceased operating in Canada within the previous year,***
  - ***the 20 former businesses of the same type as the unit being offered operated by the franchisor or its associate or affiliate that ceased operating within the previous year and are geographically closest to the unit;***
- ***information in table format showing, without geographical restriction (identified by Canadian province or territory or, if outside Canada, by state, province or comparable jurisdiction)***
  - ***the number of franchises and the number of businesses operated by the franchisor or its associate or affiliate operating at the end of each of the franchisor's last three fiscal years,***
  - ***the number of franchises and the number of businesses operated by the franchisor or its associate or affiliate that were transferred during each of the franchisor's last three fiscal years,***
  - ***the number of franchises and the number of businesses operated by the franchisor or its associate or affiliate that were operating at the beginning of each of the franchisor's last three fiscal years, those that were opened during each of the years and those that ceased operating (classified by the reason) during each of the years;***
- ***estimates of***
  - ***the number of units in Manitoba to be operated by franchisees that will be granted, and the number that will open for business, in the 12 months following the disclosure,***
  - ***the number of businesses in Manitoba of the same type as the unit being offered to be operated by the franchisor or its associate or affiliate that will be established, and the number that will open for business, in the 12 months following the disclosure.***

4. Additional Disclosure Elements

Even after considering the more extensive list of disclosure items required under the ULCC Model Regulation, there are categories of disclosure not currently required under either the Model Regulation or under provincial legislative schemes that might increase transparency between franchisors and franchisees and assist prospective franchisees to make informed decisions. The Commission has considered whether disclosure of additional categories of information should be required. In some cases, a franchisor might consider these items to be material facts and provide disclosure in any event, but this would depend on the franchisor's interpretation of their relevance in the circumstances. In the Commission's view, elements that are likely to constitute material facts should be specified in the regulations, to avoid the uncertainty in interpretation that has arisen with respect to the Ontario Act and regulations.

The consultation paper identified some categories of disclosure that are not specifically required under either current provincial regulations or the ULCC Model Regulation.[106] The Commission received comments on these and other categories of disclosure (some aspects of these categories overlap with issues discussed earlier in this report). One submission expressed the view that several categories of information should not be subject to disclosure, because of its confidential nature. These included:

- settled litigation and terms of settlement;
- arbitration and mediation proceedings;
- confidentiality agreements signed by current and former franchisees;
- bankruptcy and insolvency proceedings relating to officers, directors and partners with management responsibilities, unless there is a clear and meaningful definition of "management responsibilities";
- information respecting the parents, predecessors, affiliates and associates of the franchisor, unless they constitute a "franchisor's associate" as defined in Canadian legislation;
- gross up provisions to compensate foreign franchisors for the cost of royalty withholding tax;
- the source of supplier rebates or other benefits and how they are calculated from named suppliers; and
- whether the franchisor or any officer of the franchisor has an interest in a required supplier unless that interest constitutes control.[107]

On the other hand, the submission suggested that mandatory disclosure should be extended to:

- settled litigation and terms of settlement if the terms of settlement are otherwise available in a public forum;
- the background, market conditions and risk factors relating to the nature of the business if these items are clearly defined so as to eliminate uncertainty in the degree of disclosure

[106] Some of the listed categories are required under the U.S. or Australian legislative schemes.

[107] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007).

required;

- information as to how the franchisor may compete with franchisees through alternative distribution channels;
- bankruptcy and insolvency proceedings relating to officers, directors and partners, provided that the specific officers are defined;
- whether the franchised outlet being offered is a resale or has been acquired by the franchisor for resale; and
- details concerning advertising contributions, maintenance of an advertising fund, policies with respect to expenditures from the advertising fund and procedures for accounting for the advertising fund.[108]

One submission recommended that disclosure be required with respect to whether the franchisor may compete with franchisees through channels such as the internet; the number of mediation or arbitration cases and settled litigation matters conducted in the previous 10 years; the supports required to be provided by the franchisor under the franchise agreement and the number of sales of the same franchised outlet.[109] Another urged "[f]ull disclosure of prior franchisor/franchisee legal disputes".[110]

An experienced Manitoba franchise law practitioner argued that the disclosure document should include all information relating to the business affairs and financing of related or associated companies that act as the sub-lessor where franchise premises are subleased by the franchisee from a company related to the franchisor. In this case, there are usually cross default provisions so that a default by the franchisee under one agreement constitutes default under the other. However, the agreements do not generally include reverse provisions that provide that default by the franchisor or related company under one agreement constitutes default under the other, so that if the franchisor goes out of business, the franchisee remains liable for the payment of rent and other lease obligations.[111]

In the Commission's opinion, there are sound arguments to support the disclosure of some categories of information mentioned above.

(a) Litigation and Alternative Dispute Resolution

Existing Canadian franchise regulations require the disclosure of civil actions pending against the franchisor, the franchisor's associate or a director, general partner or officer of the franchisor involving allegations of misrepresentation, unfair or deceptive business practices or a violation of a law that regulates franchises or business (in P.E.I., this applies only to a law that regulates franchises).

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[108] *Ibid*.

[109] Submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007).

[110] Submission by A. Donald (August 19, 2007) at 1.

[111] Submission by A.L. Weinberg (July 18, 2007).

Currently, the disclosure of information about resolved franchisor-franchisee disputes is limited to those proceedings that reached final determination in court. The Commission has already recommended that disclosure be required of the details of settled civil actions where the terms of settlement were materially adverse to the person disclosing. However, as discussed in chapter 2, franchise agreements may require binding arbitration, and many disputes may not reach the courts; in other cases the resources of a franchisee whose business has failed to fund lengthy litigation may be limited. Disclosure of the number of disputes that were resolved through mediation or arbitration proceedings would provide franchisees with a more complete picture of a franchisor's relationship with franchisees.

The revised FTC Rule will also require disclosure of material litigation commenced by franchisors during the preceding year. In its Statement of Basis and Purpose, the FTC quoted the submission of an association of Burger King franchisees who supported disclosure of franchisor initiated litigation:

> … the required disclosure of franchisor-initiated litigation would further aid potential franchisees by serving as an indicator of how franchisors resolve their disputes, and whether or not such franchisors are quick to resort to litigation in order to resolve disputes. The possibility of extensive litigation is important to a potential franchisee, as it may affect the calculation of costs involved in acquiring such a franchise. In addition, the continued threat of litigation from the franchisor may well affect later dealing between the parties, and as such is critical information of which the franchisee should be aware.[112]

It is important to note that this information is not always negative:

> …franchisor-initiated litigation is material information that prospective franchisees need in order to assess a critical aspect of the franchise relationship – the nature of disputes and the level of litigation within a franchise system… we agree with the commentators who made the point that franchisor suits to enforce system standards could be viewed as a positive attribute, showing that the franchisor is willing to maintain uniformity for the benefit of the entire system. A franchisor's willingness to protect its system is a material fact about the franchise relationship that should be disclosed to prospective franchisees.[113]

RECOMMENDATION 24

The regulations should require disclosure of the number of:

- ***lawsuits that were initiated by the franchisor against franchisees in the 10 year period immediately preceding the date of disclosure;***

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[112] U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15480.

[113] *Ibid*. at 15481. The FTC declined to broaden the disclosure requirement beyond the franchisor-franchisee relationship, as some had recommended, to litigation involving another franchise system owned by the franchisor or involving affiliates or third-party suppliers, as its core concern was the relationship between the franchisor and its franchisees.

- ***franchisor–franchisee disputes that were resolved through mediation or arbitration in the 10 year period immediately preceding the date of disclosure;***
- ***franchisor–franchisee disputes that are pending in mediation or arbitration at the date of disclosure.***

The information should be identified by province and, if franchises are operated in other countries, by country.

(b) Confidentiality Agreements

In the Commission's view, disclosure of the number of current and former franchisees that are subject to confidentiality agreements would also assist prospective franchisees in evaluating the extent and quality of information that may be obtained from contacting others within the franchise system. The revised FTC Rule contains a new provision requiring franchisors to disclose whether any franchisees have signed confidentiality agreements within the previous three years. If so, the franchisor must insert a statement advising prospective franchisees that not all current and former franchisees will be able to communicate with them. The franchisor may also, at its option, disclose the number and percentage of current and former franchisees who signed confidentiality agreements as well as the circumstances under which they were signed.[114]

The FTC observed that the use of confidentiality provisions may effectively eliminate "one crucial source of information",[115] those current and former franchisees who have had disputes with the franchisor. A franchisor could use such agreements to ensure that prospective franchisees are able to speak only with successful franchisees who will give a positive report. While recognizing that confidentiality agreements have a valid role in the context of encouraging settlement and protecting trade secrets, the FTC reported that it was convinced that the signing of such agreements "may impede prospective franchisees' ability to conduct due diligence investigations of franchise offerings, undercutting the primary goal of pre-sale disclosure".[116]

In the Commission's opinion, the fact that some current or former franchisees are unable to speak freely due to confidentiality agreements is very important information for a prospective franchisee. The regulations should require disclosure of the number of current or former franchisees that are subject to a confidentiality agreement at the time the disclosure is made. The requirement should not apply to confidentiality agreements that are required by the franchisor for the purpose of providing disclosure (discussed in more detail below) and that apply solely to prohibit the release or use of pre-sale disclosure information.

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[114] *FTC Franchise Rule*, *supra* note 26, 16 C.F.R. § 436.5(t)(7).

[115] U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15505.

[116] *Ibid*. at 15506.

RECOMMENDATION 25

The regulations should require disclosure of the number of current or former franchisees that are subject to confidentiality agreements, other than confidentiality agreements entered into solely for the purpose of providing pre-sale disclosure. The information should be identified by province and, if franchises are operated in other countries, by country.

(c) History of a Franchise Outlet

The ULCC Model Regulation requires the disclosure of the number of franchises that closed within the previous three years, including the number of franchises that were terminated by the franchisor or franchisee and the number that were transferred by the franchisee or re-acquired by the franchisor. The Commission supports the disclosure of this information, but in the Commission's view, more detail is required. A prospective franchisee may need more specific information with respect to the ownership history of the outlet being offered, or with respect to franchise failures in the area.

The case of *Machias v. Mr. Submarine Ltd.*[117] presents an illustration. In *Machias*, the franchisor had provided inaccurate financial information to the franchisee at the time of purchase, and had also failed to inform the franchisee that several other Mr. Submarine franchises had failed in Montreal over previous years. The franchise being offered "was not an exciting opportunity in a new market as represented by the Defendant. Mr. Sub hoped to re-enter a market that had failed in the past."[118]

The Federal Trade Commission heard evidence to similar effect:

> [T]he IL AG asserted that a number of successive sales of a franchised outlet could indicate "churning", the practice whereby a franchisor turns a blind eye to franchisee failures – or worse, encourages them – in order to sell the same outlet repeatedly. The IL AG urged the Commission to require franchisors to provide a prospect with a detailed site history when a buyer is being directed to a particular location. …
>
> The Commission agrees, but is convinced that a five-year reporting period is warranted in order to allow sufficient time to identify a trend. … Surely, significant turnover at a particular location might indicate a lack of promised support for the location, or worse, as the IL AG explained, a possible franchisor strategy to have the franchisee fail in order to resell the unit. We believe any compliance costs to the franchisor, therefore, are outweighed by the countervailing benefits to prospective franchisees.[119]

The Commission recognizes that information respecting repeated sales of the same franchised outlet, or repeated franchise failures in the local market will often be material facts

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[117] (2002) 24 B.L.R. (3d) 228 (Ont. S.C.J.).

[118] *Ibid*. at para. 25.

[119] U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15504.

that must be disclosed in any event. However, it is difficult to envisage a situation in which this information would not be of interest to a prospective franchisee, and the regulations should specifically require disclosure. The Commission considers that a ten year period is a reasonable reporting period. Where the franchise is to be sited in a new location, or the history of the location is consistent, the burden to the franchisor will not be onerous. Where there has been significant turnover, the information is even more important for the franchisee.

RECOMMENDATION 26

The regulations should require disclosure of the history of the ownership and operation of the franchise outlet being offered, including whether the franchise is a resale by a franchisee or has been acquired by the franchisor for resale, and any repeated sales of the franchise. The regulations should also require disclosure of repeated sales of other current franchises within Manitoba and of the 20 current franchises that are geographically closest to the franchise being offered.

(d) Franchisee Support Resources and Methods

One of the significant factors that make franchises an enticing opportunity for many prospective franchisees is the ongoing assistance and support offered by the franchisor:

> The offer of business assistance is one of the hallmarks of a franchise system … promises of assistance made to induce prospective franchisees are material, especially to those prospects with "little or no experience at running a business". …
>
> [M]isrepresentation about the level of support and assistance is one of the most common problems in franchise cases.[120]

The Model Regulation does not specifically require the disclosure of franchisor support resources and methods, although information about some forms of support, such as training and manuals, must be included. The Commission considers that more comprehensive disclosure of the support a franchisee may expect to receive would be helpful in clarifying at the outset the nature of the relationship that a franchisee may anticipate with the franchisor. Such disclosure may help to prevent future conflict, or may persuade the franchisee to investigate other franchise opportunities if the resources offered do not meet the franchisee's expectations.

RECOMMENDATION 27

The regulations should require disclosure of the resources and methods available for franchisee support, including any costs to be borne by the franchisee for the support.

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[120] *Ibid.* at 15489, n. 475, 477.

(e) Associated Sub-Lessors

The Commission received a suggestion that disclosure should be required of the business background of an individual or corporation that is related to or associated with the franchisor and acts as the sub-lessor of the franchised premises.[121] The landlord-tenant relationship can have a significant impact on the business affairs of a franchise, particularly given the common use of cross-default provisions in franchise and lease agreements, and the Commission agrees that where the landlord and franchisor are related or associated (although not necessarily in a relationship of control),[122] disclosure should be required. The regulations should also require the disclosure of the matters set out in paragraphs 3(c) to (f) of the Model Regulation (convictions related to business practices, administrative orders or penalties, findings of civil liability related to business practices and bankruptcies).

RECOMMENDATION 28

The regulations should require disclosure of the business background of an individual or corporation that is related to the franchisor and that acts as the lessor or sub-lessor of the franchised premises. The regulations should also require disclosure of the matters set out in paragraphs 3 (c) to (f) of the ULCC Model Regulation.

(f) Background, Market Conditions and Business Risk Factors

As we have made clear, the Commission strongly supports broad franchisor disclosure; prospective franchisees are typically at a disadvantage in franchise negotiations, partly because the franchisor controls access to key information about the franchise that is not publicly available. On the other hand, as one submission asserted, the franchise relationship is fundamentally a business to business relationship,[123] and the prospective franchisee bears responsibility to conduct a diligent and thorough investigation of matters for which information is publicly available before purchase, and to obtain professional advice.

The Commission does not, therefore, consider it necessary to include a broad requirement that a franchisor disclose the background, market conditions and risk factors relating generally to the nature of the franchise business. Where such information constitutes a material fact, a franchisor will be required to disclose it in any event. In the Commission's view, further broad requirements with respect to general market conditions and factors would result in an unwarranted level of ambiguity and uncertainty respecting the standard of disclosure.

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[121] Submission by A.L. Weinberg (July 18, 2007).

[122] See, for example, the definition of "associate" in the *Canada Business Corporations Act*, *supra* note 69, s. 2(1).

[123] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007).

RECOMMENDATION 29

The regulations should not require disclosure of the background, market conditions and risk factors relating generally to the nature of the business.

(g) Summary of Terms and Obligations

The Ontario Bar Association Joint Subcommittee on Franchising recommended that the Ontario regulation be amended to provide:

- a concise summary in narrative or tabular form of the provisions of the franchise agreement that deal with a list of items, including termination, assignment and transfer of the franchise agreement, modifications of the agreement and limitations of liability;
- a table listing the principal obligations of the franchisee under the franchise agreement, including fees, compliance with standards and restrictions on goods and services to be sold; and
- a concise description, with cross references to the franchise agreement, of the franchisor's principal pre- and post-opening obligations.[124]

The amended Australian Franchising Code of Conduct requires a disclosure document to include references to the franchisee's and franchisor's principal obligations under the franchise agreement and references to the provisions of the franchise agreement dealing with termination, transfer, assignment, renewal, expiry and mediation.[125] Similarly, the amended FTC Rule requires a disclosure document to include tables of the franchisee's principal obligations under the franchise agreement and of the agreement's provisions dealing with renewal, termination, transfer and dispute resolution.[126]

RECOMMENDATION 30

The regulations should require that a disclosure document include summaries of the franchisee's and franchisor's principal obligations under the franchise agreement, as well as a summary of the terms of the franchise agreement dealing with termination, transfer, assignment, renewal, expiry and alternative dispute resolution methods.

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[124] OBA Joint Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 34-41.

[125] *Franchising Code of Conduct*, *supra* note 71, Sch., Annexure 1, ss. 15.1-17.1.

[126] *FTC Franchise Rule*, *supra* note 26, 16 C.F.R. § 436.5(i) and (q).

E. DISCLOSURE DOCUMENT

1. Risk Warning

The Ontario and P.E.I. regulations and the ULCC Model Regulation require a risk warning to be presented at the beginning of the disclosure document. The warning includes statements, which must be presented together, that prospective franchisees should seek information on the franchisor and the franchisor's business background, banking affairs, credit history and trade references, should seek independent legal and financial advice and should contact current and previous franchisees before entering into the franchise agreement. The statements also advise that lists of current and previous franchisees and their contact information are included in the disclosure document.

The Ontario regulation adds a brief explanation of a commercial credit report and that the cost of goods and services acquired under the franchise agreement may not correspond to the lowest cost of the goods and services available in the marketplace.

The Commission supports the use of these warnings. In the Commission's opinion, the risk warning should also notify franchisees that franchising in Manitoba is governed by a franchise Act and regulations, and that franchisees and franchisors have specific legal rights and duties under the Act and regulations.

RECOMMENDATION 31

The regulations should require a risk warning at the beginning of a disclosure document, which should include the statements set out in the Ontario and P.E.I. regulations and the ULCC Model Regulation. The warning should also include a statement that franchisees and franchisors in Manitoba have specific rights and duties under the Act and regulations.

2. Wrap-Around Disclosure Document

The consultation paper asked whether franchisors should be allowed to use "wrap-around" disclosure documents, as is the case in Alberta and P.E.I. The Alberta regulation provides that a franchisor "may use a document authorized under the franchise law of a jurisdiction outside Alberta as its disclosure document to be given to a franchisee, if supplementary information is included that sets out any material changes to the document from that jurisdiction so that it complies with the requirements of this Regulation".[127] The P.E.I. regulations use similar wording.

The Ontario regulation does not expressly permit the use of wrap-around documents. This has led to a debate about whether wrap-arounds may be used in compliance with the

[127] *Alberta Regulation*, *supra* note 31, s. 2(2).

Ontario Act, and more specifically, whether the U.S. UFOC document may be used in Ontario with a wrap-around.[128]

Under the Ontario Act, the other provincial statutes and the Model Bill, disclosure must also be "accurately, clearly and concisely set out". The amended FTC Franchise Rule includes a similar requirement.[129]

Those in support of the use of the UFOC have argued that the Ontario Act does not prohibit the use of wrap-arounds, UFOC disclosure is more comprehensive and meaningful than disclosure by Ontario franchisors, and the UFOC is a clearer, more specific and better formatted document than those used in Canada.[130] The argument against adapting the UFOC for use in Canada has pointed out that the economic differences and disparities in disclosure requirements between jurisdictions would mean that significant amounts of time and money would be required to prepare the wrap-around in any event. As well, "[i]f the required changes to conform the foreign disclosure document to Ontario's standards are so extensive that the reader must continually flip back and forth between the text of the foreign disclosure document and the text of the addendum or wrap-around, then the disclosure is likely neither clear nor concise".[131] Finally, since the Ontario regulation was made after the Alberta regulation, the choice not to authorize the use of wrap-arounds would appear to be deliberate.

The ULCC Uniform Franchises Act Working Group had considered authorizing the use of wrap-around documents, but concluded that "there was no need to permit the use of wrap-around documents in a Canadian harmonized system, and that the use of such statements would negatively affect the clarity of disclosure documents as a whole".[132] On the other hand, the concept of wrap-around disclosure documents was supported by those respondents to the consultation paper who addressed the issue.[133] It was suggested that a provision allowing the use of wrap-around documents would be consistent with the goal of harmonization among the provinces and would limit any additional costs that franchisors might incur in complying with Manitoba's disclosure requirements.

The jurisdictions that permit the use of wrap-around documents do not require the

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[128] See Debi M. Sutin and Arthur J. Trebilcock, "The Case Against the Use of Wrap Around Disclosure Documents in Canada" (Fall 2004) 24 *Franchise L.J.* 83 and Peter M. Dillon, "The Case for the Use of Wrap Around Disclosure Documents in Canada" (Fall 2004) 24 *Franchise L.J.* 73 [Dillon, "Wrap Around Disclosure Documents"]. As discussed, use of the new FTC Franchise Disclosure Document is required effective July 1, 2008.

[129] The amended FTC Franchise Rule adopts the plain English requirement of the UFOC Guidelines; all required information must be disclosed "clearly, legibly, and concisely in a single document using plain English": *FTC Franchise Rule*, *supra* note 26, 16 C.F.R. § 436.6(b).

[130] Dillon, "Wrap Around Disclosure Documents", *supra* note 128.

[131] Trebilcock, *supra* note 34 at 13.

[132] Uniform Law Conference of Canada, Uniform Franchises Act Working Group, *Uniform Franchises Act Report of the Working Group* (August 2005) at 4, online: <http://www.chlc.ca/en/poam2/Uniform_Franchises_Act_Rep_En.pdf> [ULCC, *Uniform Franchises Act Report of the Working Group*].

[133] Submission by E. Levitt (July 19, 2007); submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007); submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007).

original disclosure document to be one that originates from a Canadian jurisdiction. This seems to imply that a document from another country could be used, with supplementary material to bring the document into compliance with provincial requirements, assuming that the requirement to be accurate, clear and concise can be satisfied.[134]

One submission suggested that Manitoba include a provision allowing wrap-around disclosure documents, so long as the Act also included a requirement to be clear and concise. As well, the submission suggested that the legislation or regulations require the use of an index and summary in each disclosure document.[135]

The Commission finds the arguments in support of allowing the use of wrap-around documents to be persuasive. Such a provision may be unnecessary in a future more uniform system, but at present it may ease the compliance burden for franchisors and should not disadvantage franchisees if the document is accurate, clear and concise.

RECOMMENDATION 32

The regulations should allow the use of a disclosure document from a jurisdiction outside Manitoba if supplementary information is included that is necessary to comply with the Manitoba Act and regulations.

RECOMMENDATION 33

The regulations should require the disclosure document to be accurately, clearly and concisely set out.

3. Substantial Compliance

The Alberta and P.E.I. regulations provide that a disclosure document is properly given under the Act if the document is "substantially complete".[136] The Ontario regulation and the ULCC Model Regulation do not include a similar provision, and there has been criticism on this

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[134] Levitt has noted that there is a concern with using a large and complex foreign disclosure document with a wrap-around even in P.E.I., where wrap-arounds are authorized, given the "clear and concise" requirement: Edward N. Levitt, "Annual Legislative Update 2006", *supra* note 34 at 45. Zaid also cautions that "over-disclosure may be irrelevant, misleading or misrepresentative" so that if an international disclosure document is to be used, extraneous or irrelevant information should be deleted or modified: Zaid, *Franchise Law*, *supra* note 25 at 68.

[135] Submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007). The Ontario Bar Association Joint Subcommittee also recommended that the Ontario regulation authorize the use of wrap-around documents: OBA Joint Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 5.

[136] See *Emerald Developments Ltd. V. 768158 Alberta Ltd. (c.o.b. Staccato's)*, 2001 ABQB 143, 287 A.R. 151: in dismissing an application for summary judgment, the court commented that "the legislation's focus is on protecting the franchisee from making a decision to invest in the absence of sufficient or accurate information, but this is to be assessed on a substantive, not a technical, basis", at para. 18.

point:

> What happens if the Canadian disclosure document has the wrong address of the franchisor? Because that piece of information is required, does its omission rise to the same level as, say, omission of or a material error in the financial statements, which are also required? If the answer is yes, then one can see the level of risk associated with the current disclosure regime in Canada. If the answer is no, then one accepts the fact that a purposive approach is required to the interpretation of presale disclosure laws, and not the bright-yellow-line approach currently in vogue and now endorsed by the ULCC model.[137]

All respondents who addressed the question of whether disclosure documents should be acceptable if they are substantially complete supported the concept.[138] As one submission expressed, "minor omissions or errors in a disclosure document should not result in extreme remedies like rescission".[139]

It seems to the Commission to be somewhat incongruous to focus an entire statute on disclosure, and then provide that a disclosure document is satisfactory if it is substantially complete. Nevertheless, the Commission is persuaded that it is appropriate to provide some relief for franchisors for minor errors. A franchisor that is protected from liability for minor errors may also be more likely to provide prompt corrections of any inaccurate information that it has inadvertently provided. However, protection for prospective franchisees who may have been misled by inaccurate information should be clearly preserved.

The Commission prefers the term "substantially complies" to "substantially complete", as it more accurately captures the intended concept. A disclosure document may be complete, in that it contains all of the information required, but contain a minor error for which an extreme remedy is not justified.

Protection from liability for minor defects is provided in other Manitoba legislation, including *The Personal Property Security Act, The Securities Act, The Builders' Liens Act, The Warehousemen's Liens Act, The Life Leases Act, The Mines and Minerals Act* and *The Manitoba Public Insurance Corporation Act*.[140] Subsection 61(2) of *The Securities Act*, for example, provides that the director shall not issue a receipt for a prospectus if he or she considers that it

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[137] Peter M. Dillon, "Will Franchising Survive As a Business Model Under Canadian Laws and Regulations?" (Summer 2006) 25 *Franchise L.J.* 32 [Dillon, "Will Franchising Survive?"]. The author has argued that Ontario is "the toughest jurisdiction in the world in which to franchise": Dillon, "Ontario Franchise Developments in 2004", *supra* note 25 at para. 1. He suggests that Ontario should include a "substantially complete" saving provision to mitigate the "open-ended" requirement to disclose all material facts: Dillon, *Increasing Legislative Harmony*, *supra* note 39; Dillon, "Why Ontario Should Get Active in NASAA", *supra* note 39.

[138] Submission by E. Levitt (July 19, 2007); submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007); submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007).

[139] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 6.

[140] *The Personal Property Security Act*, C.C.S.M. c. P35; *The Securities Act*, *supra* note 40; *The Builders' Liens Act*, C.C.S.M. c. B91; *The Warehousemen's Liens Act*, C.C.S.M. c. W20; *The Life Leases Act* C.C.S.M. c. L130; *The Mines and Minerals Act*, C.C.S.M. c. M162; and *The Manitoba Public Insurance Corporation Act*, C.C.S.M. c. P215.

"does not comply in a substantial respect with a requirement of this Part or the regulations".[141]

In the Commission's opinion, section 170 of *The Real Property Act* provides a useful model. Section 170 provides as follows:

> 170. No proceeding under this Act is invalid by reason of any informality or technical irregularity therein or of any mistake not affecting the substance of the proceeding.[142]

RECOMMENDATION 34

The Act should provide that:

- ***a disclosure document is valid if it substantially complies with the Act and regulations;***
- ***no disclosure document is invalid by reason of any informality or technical irregularity or mistake not affecting the substance of the document.***

4. Electronic Delivery

All Acts except Alberta's provide that a disclosure document may be delivered personally, by registered mail or by any other prescribed method.[143] Until recently, no Canadian legislative scheme expressly provided for electronic delivery of a disclosure document. However, P.E.I. recently became the first jurisdiction to prescribe electronic delivery as an approved method.

The P.E.I. regulations provide that a disclosure document may be delivered by electronic means or in machine-readable media, if it is delivered as a single, integrated document or file, has no extraneous content beyond what is required or permitted by law, has no links to or from external documents or content, is delivered in a form that intrinsically enables the recipient to store, retrieve and print it, and conforms in content and format to the requirements of the law. The franchisor must keep records of electronic delivery and must receive a written acknowledgement of receipt from the prospective franchisee.[144]

Manitoba, like other provinces, has enacted legislation in recent years to facilitate the electronic delivery and receipt of commercial documents. *The Electronic Commerce and*

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[141] *The Securities Act*, *ibid*., s. 61(2)(a)(i).

[142] *The Real Property Act*, C.C.S.M. c. R30, s. 170.

[143] The Alberta Act does not specify any particular method of delivery of disclosure documents: *Alberta Act*, *supra* note 1.

[144] *P.E.I. Regulations*, *supra* note 56, s. 2.

Information Act[145] authorizes the production and inspection of electronic documents and the formation of electronic contracts. An offer, acceptance or any other matter material to a contract may be expressed by means of an electronic document or by an act that electronically communicates the offer. A person is not required to produce or receive information electronically without his or her consent, although consent may be inferred from conduct. The Act does not affect any other law that authorizes, requires or regulates the use of electronic means to communicate or record information or documents.

P.E.I. appears to have based the wording of its electronic delivery provisions on proposed text for the regulation of electronic delivery of disclosure documents issued by NASAA in 2003.[146] The wording is nearly identical, except that the NASAA text does not require a written acknowledgement of receipt; instead, the franchisor must be able to prove that it delivered the document electronically in compliance with the section.

The amended FTC Franchise Rule also provides for electronic delivery of disclosure documents. A receipt by the prospective franchisee is required, but the Rule contemplates the use of electronic signatures and electronic acknowledgements of receipt of documents (under the Rule, "signature" includes written signatures as well as electronic signatures, passwords, security codes and other devices that allow the franchisee to authenticate his or her identity).[147] The Australian Franchising Code of Conduct similarly notes that franchisors are authorized to provide information to a prospective franchisee electronically if the information will be readily accessible in a useable form for subsequent reference and the franchisee consents to electronic delivery. Written consent is not specifically required.[148] The Ontario Bar Association Joint Subcommittee on Franchising has recommended that electronic delivery be permitted under the Ontario regulation, under provisions similar to those of the P.E.I. regulations, with the consent of the prospective franchisee. Rather than requiring a written acknowledgement of receipt, however, the Joint Subcommittee recommends that the regulations require that the franchisor be able to prove that it delivered the disclosure document in compliance with the Act and regulation, as proposed in the NASAA text.[149]

The Commission agrees that, in light of current commercial practices, the electronic delivery of a disclosure document should be authorized, where the prospective franchisee consents. The NASAA model and P.E.I. regulations largely reflect reasonable requirements and protections for electronic delivery.

The Commission considers it unnecessary to require the franchisor to obtain a written

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[145] C.C.S.M. c. E55; other provinces have also enacted electronic commerce legislation. See the Uniform Law Conference of Canada *Uniform Electronic Commerce Act*, online: <http://www.ulcc.ca/en/us/index.cfm?sec+1&sub=1u1>.

[146] North American Securities Administrators Association, *Statement of Policy Regarding Electronic Delivery of Franchise Disclosure Documents* (September 14, 2003), online: <http://www.nasaa.org/content/Files/Electronic_Delivery_Franchise_Disclosure.pdf>.

[147] *FTC Franchise Rule*, *supra* note 26, 16 C.F.R. § 436.1(u).

[148] *Franchising Code of Conduct*, *supra* note 71, Sch., s. 10, note; *Electronic Transactions Act 1999* (Cth.), s. 9(1).

[149] OBA Joint Subcommittee on Franchising, *supra* note 20, "The Draft Revision and Comments" at 48-51.

acknowledgement of receipt from the prospective franchisee. It is in a franchisor's interest to obtain proof of receipt, and a franchisor may choose to obtain a written acknowledgement. Alternatively, an electronic signature or other secure method of electronic acknowledgement of receipt is sufficient under *The Electronic Commerce and Information Act* and for these purposes.

RECOMMENDATION 35

The Act should authorize the delivery of a disclosure document personally, by registered mail or by any prescribed method. The regulations should authorize the delivery of a disclosure document by electronic means, as set out in the P.E.I. regulations, except that:

- ***the consent of the prospective franchisee to electronic delivery should be required; and***
- ***receipt may be acknowledged by an electronic signature or other secure method of electronic acknowledgement.***

5. Cooling Off Period

One suggestion received by the Commission was that Manitoba should follow the example set out in the Australian Code and provide a seven day "cooling off" period following the signing of a franchise agreement. As well, a franchisor should be required to obtain a signed statement from a prospective franchisee that the franchisee obtained independent advice or was told that advice should be sought and decided not to seek it.[150]

These suggestions have merit, but in the Commission's view, the requirement to provide disclosure 14 days before an agreement is signed gives a prospective franchisee sufficient opportunity to study the information provided, consider the advice to obtain professional assistance and reflect on the purchase decision. An additional period of time in which to reconsider and a requirement for a signed statement would not significantly enhance the existing requirements.

F. EXEMPTIONS FROM DISCLOSURE

1. Confidentiality and Site Selection Agreements

A disclosure document must be delivered to a prospective franchisee 14 days before the signing of the franchise agreement or "any other agreement relating to the franchise". As a result, typical agreements secondary to the franchise agreement, such as leases, security agreements, guarantees and licence agreements, are captured by the disclosure requirement, and disclosure must be provided 14 days before the agreement is signed.

[150] Submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007).

All Acts except Ontario's exempt confidentiality and site selection agreements from the disclosure requirement. This exemption means that a franchisor may enter into an agreement with a franchisee about a prospective franchise site, or require a prospective franchisee to sign a confidentiality agreement prohibiting the release or use of disclosure information, before providing detailed disclosure about the franchisor's finances. In Ontario, these exemptions do not apply. A franchisor cannot enter into a site selection or confidentiality agreement before providing disclosure, as the agreement would likely be an agreement relating to the franchise, triggering the 14 day disclosure requirement.[151] As a result,

> [i]n the absence of the ability to secure some form of initial financial commitment or confidentiality covenant from prospective franchisees, the Ontario franchisor must be more wary of "tire kickers" or potential competitors who wish to collect information and documents without serious intentions to proceed.[152]

Respondents to the consultation paper who addressed these issues supported exemptions for site selection and confidentiality agreements.[153] For example, one respondent explained:

> Franchisors are not required to file their disclosure documents with any regulatory body in Canada and should be entitled to have the information contained in a disclosure document maintained in confidence as between the franchisor and the prospective franchisee and the prospective franchisee's advisors. Also, site selection agreements are often necessary to preserve sites in advance of disclosure ...[154]

Another respondent observed that "protecting franchise trade secrets and confidential information benefits franchisees as well as the franchisor. Franchisees would lose much of the economic value of their business if the information they rely upon to operate their franchise became publicly available such that others could easily duplicate the franchise business …".[155]

The ULCC Uniform Franchises Act Working Group held the view that a prospective franchisee would not be prejudiced by the signing of a site selection or confidentiality agreement in advance of disclosure.[156] However, as provided in the Model Bill, an agreement should not qualify for the exemption if it requires confidentiality in respect of information that is in the public domain, that is disclosed with consent or without breaching the agreement or that is disclosed to other franchisees, to a franchisee organization or to the franchisee's professional advisors. The Commission shares the view of the Working Group.

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[151] Levitt, *Critical Compliance Issues*, *supra* note 34.

[152] Leblanc and Dillon, *supra* note 3 at 8.

[153] Submission by E. Levitt (July 19, 2007); submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007); submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007).

[154] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 7.

[155] Submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007) at 20.

[156] ULCC, *Uniform Franchises Act Working Group Commentary*, *supra* note 23 at 15.

RECOMMENDATION 36

The Act should provide an exemption from the advance disclosure requirement for site selection agreements and for confidentiality agreements restricting the release or use of disclosure information. The confidentiality agreement must not apply to information that is:

- ***in the public domain;***
- ***disclosed with consent or without breaching the agreement; or***
- ***disclosed to other franchisees, to a franchisee organization or to the franchisee's professional advisors.***

2. Refundable Deposits

The Alberta Act also exempts fully refundable deposits from the advance disclosure requirement, so that a franchisor may require a refundable deposit before providing disclosure. The deposit must not exceed by the amount prescribed by regulation (set at 20% of the initial franchise fee),[157] must be refundable without any deductions and must be given under an agreement that does not bind the prospective franchisee to enter into a franchise agreement. The ULCC Model Bill did not incorporate this exemption.

Respondents' opinions varied with respect to refundable deposit exemptions. One submission supported the concept, with qualifications:

> … fully refundable deposits are necessary for a franchisor to be able to obtain a conditional commitment from a prospective franchisee without having to insist upon payment of the entire initial fee. However, there should be a time limit attached to refundability of the deposit as, for example, not later than one year after payment of same.[158]

Another submission recommended against providing a disclosure exemption for refundable deposits, arguing that this exposes the franchisee to "unscrupulous franchisors claiming to refund the deposit but who, in reality, will refuse to do so given the opportunity … not only will a franchisee be exposing himself to potential abuse but he also will be paying money into an enterprise he knows very little about".[159] It was suggested that alternatively, Manitoba legislation should allow franchisors to request a franchisee to make a deposit with his or her own lawyer as a show of faith. The deposit should not exceed 5% of the total franchise fee, to a maximum of $5,000.[160]

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[157] *Alberta Regulation*, *supra* note 31, s. 5. The Australian Franchising Code also provides that the disclosure requirement applies with respect to non-refundable payments only: *Franchising Code of Conduct*, *supra* note 71, Sch., s. 10(d)(ii).

[158] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 7. The submission by E. Levitt (July 19, 2007) also supported the exemption.

[159] Submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007) at 19.

[160] *Ibid*. at 19-20.

In the Commission's view, a provision allowing a franchisor to require a franchisee to make a refundable deposit with his or her legal counsel or other independent advisor in advance of disclosure would strike a reasonable balance.[161] This option would allow a franchisor to receive some assurance that the franchisee is prepared to commit to the venture before disclosing sensitive business information, and would provide security to franchisees. The maximum deposit amount should be 5% of the total franchise fee.

RECOMMENDATION 37

The Act should provide an exemption from the advance disclosure requirement for a fully refundable deposit that is placed with the franchisee's legal counsel or other independent advisor selected by mutual agreement. The deposit should be a maximum of 5% of the total franchise fee. If a franchise agreement is not executed within one year, the deposit should be fully refundable, with accrued interest refunded to the franchisee. If a franchise agreement is executed, accrued interest on the deposit should be credited to the franchisee.

3. Franchisee Transfers

All Acts provide that the obligation to provide a disclosure document does not apply to the grant of a franchise by a franchisee if:

- the franchisee is not the franchisor, the franchisor's associate or a director, officer or employee of the franchisor or the associate;
- the grant of the franchise is for the franchisee's own account; and
- the grant of the franchise is not effected by or through the franchisor.

In the case of a master franchise, the entire franchise must be granted.

As Sotos and Trebilcock point out, the rationale behind the franchisee transfer exemption is that it would not be reasonable to require the franchisee to disclose information that he or she does not possess and that would be very expensive to obtain. They note three concerns with the wording of the exemption:

- where the exemption does not apply, the requirement to provide disclosure becomes that of the franchisee (the person "granting" the franchise), rather than the franchisor;
- the wording may allow a franchisor to avoid disclosure by incorporating an affiliate and granting a franchise to a director or officer of the affiliate, who could then transfer his or her franchise without disclosure; and
- the Acts provide that a grant is not effected by or through a franchisor merely because a

[161] Note that the jurisdiction of the court to relieve against forfeiture would still apply: *The Court of Queen's Bench Act*, C.C.S.M., c. C280, s. 35.

> fee must be paid in "an amount set out in the franchise agreement". There is no reason to deny the exemption if the agreement charges a fee to be ascertained at a later date (for example, a fee ascertained in reference to the regular franchise fee charged at the time of the transfer).[162]

The FTC Rule also provides for franchisee transfer exemptions. However, the amended Rule clarifies that the exemption is not available where an existing franchisee is engaged in repeated franchise sales on behalf of the franchisor.[163] The Commission agrees with this restriction.

RECOMMENDATION 38

The Act should provide an exemption from the disclosure requirement for the sale of a franchise by a franchisee as set out in the ULCC Model Bill. The Act should also provide that:

- ***where the exemption does not apply, the franchisor is required to provide the disclosure;***
- ***the exemption does not apply where the franchisee is a director or officer of an affiliate of the franchisor;***
- ***the exemption may apply where a fee payable to the franchisor is referenced but ascertainable at a later date; and***
- ***the exemption does not apply where the franchisee is engaged in repeated franchise sales.***

4. Grant to a Director or Officer

All Acts provide that disclosure is not required when a franchise is granted to an individual who has been a director or officer of the franchisor for at least six months. The Model Bill and the P.E.I. and New Brunswick Acts clarify that this period is "immediately before the grant of the franchise"; in Ontario and Alberta, it appears that the exemption could apply to a director or officer who had resigned years ago.[164]

The amended FTC Franchise Rule adds a new exemption from disclosure for sales to officers, owners and managers of a franchise:

> In such circumstances, it reasonably can be assumed that the prospective franchisee already is familiar with every aspect of the business system and the associated risks. Thus, disclosure would serve little purpose. Indeed, in some instances, a company may wish to offer units only to its owners, officers, and managers. If not exempt from the Rule, these companies would have to go through the burden and expense of creating a disclosure

[162] Sotos and Trebilcock, "Exemptions and Exclusions", *supra* note 30 at 3-6.

[163] *FTC Franchise Rule*, *supra* note 26, 16 C.F.R. § 436.1(j).

[164] Sotos and Trebilcock, "Exemptions and Exclusions", *supra* note 30 at 6-8.

document for isolated sales to company insiders.[165]

The FTC exemption applies to not only owners and officers of a franchise system, but also those with direct management experience. Like the Canadian Acts, the FTC Rule aims to ensure that the individuals have "recent and sufficient experience with the business";[166] the Rule requires the individual to have been associated with the company within 60 days of the sale and for a minimum of two years. The FTC noted that the requirement for at least two years' experience addresses the concerns raised that a franchisor could skirt the disclosure obligations by putting a prospective franchisee on its board of directors shortly before the sale.

The Commission agrees that an exemption from the disclosure obligations for the sale of a franchise to a business "insider" is reasonable. The Commission prefers the approach of the amended FTC Rule; comprehensive disclosure is a fundamental principle of franchise legislation and in order for the exemption to be justified it must be clear that the individual has appropriate familiarity with the franchise system and its risks. A minimum of two years' experience with the franchise should be required. As well, although it should be clear that the period of experience must be recent, a short break between the person holding an inside position and the sale of the franchise would not affect person's knowledge of the system and risks. The FTC requirement that the individual must have been associated with the system within 60 days of the sale of the franchise would allow for a short transition period.

Finally, as Sotos and Trebilcock point out, it is not necessary to limit the exemption to directors and officers. In our discussion of disclosure elements earlier in this chapter, the Commission has expressed that the important factor is not a person's title, but whether he or she exercises regular management responsibilities relating to the franchise.[167]

RECOMMENDATION 39

The Act should provide an exemption from the disclosure requirement for the sale of a franchise to an individual who has been a director or officer of the franchise, or has held regular management responsibilities in relation to the franchise, for a period of at least 24 months ending within 60 days of the sale of the franchise.

5. Renewal

The Canadian Acts contain no express requirement for continuing disclosure once the franchise agreement has been signed. In contrast, the Australian Franchising Code of Conduct requires franchisors to provide a current disclosure document to franchisees once each year, within 14 days of request.

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[165] U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15528.

[166] *Ibid.*

[167] Sotos and Trebilcock, "Exemptions and Exclusions", *supra* note 30 at 8.

While there is no general requirement to provide disclosure upon request, the disclosure provisions of the ULCC Model Bill and the Ontario, P.E.I. and New Brunswick Acts do apply to renewals and extensions of franchise agreements, under certain circumstances. Disclosure is generally required in respect of renewals and extensions, unless there has been no interruption in the operation of the business operated by the franchisee and there has been no material change since the existing franchise agreement or latest renewal or extension.[168] In Alberta, disclosure is not required on the renewal or extension of a franchise agreement.

The Australian Code and the FTC Rule also require disclosure upon renewal. In Australia, a franchisor must provide a disclosure document at least 14 days before renewing or extending a franchise agreement, and must obtain a written statement from the franchisee that the franchisee has received, read and had a reasonable opportunity to understand the disclosure document. Under the revised FTC Franchise Rule, disclosure obligations are triggered when a franchise agreement is renewed or extended, if there has been an interruption in the operation of the business or the new agreement contains terms and conditions that differ materially from the original agreement.

The Commission agrees that a franchisor should be required to provide disclosure to a renewing franchisee where there has been an interruption in the operation of the business or a material change since the latest agreement. In most cases, a renewal will take place a number of years after the previous agreement, and there will have been some material change that requires disclosure.[169] However, as noted, the revised FTC Rule also specifically requires disclosure whenever the new agreement contains materially different terms and conditions. The Federal Trade Commission explained the representations of franchisees on this topic:

> Franchisees, they have asserted, not only lack bargaining power over the renewal agreement, but also often must accept new onerous terms because they are frequently subject to covenants not to compete that effectively prevent them from continuing in the same business independently. Especially in an age of new technologies and changes in franchise marketing, renewal contracts may be significantly different from original contracts that franchisees signed 10 to 20 years ago. A renewing franchisee, for example, may reasonably wish to see Item 20 closure rates for franchises operating under the new franchise agreement.[170]

The FTC concluded that where the franchise agreement contains materially different terms and conditions, the renewing franchisee needs advance disclosure in order to make an informed decision.

The Commission agrees with the conclusion of the FTC on this point. Franchise

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[168] As discussed earlier, the definition of "material change" varies slightly, but in the ULCC Model Bill is defined as a change in the business, operations, capital or control of the franchisor, the franchisor's associate, the franchise or the franchise system that would reasonably be expected to have a significant adverse effect on the value or price of the franchise or the decision to acquire the franchise: *ULCC Model Bill*, *supra* note 18.

[169] Jones and So, *supra* note 24 at 28.

[170] U.S. Federal Trade Commission, *Final Rule*, *supra* note 29 at 15467.

agreements that provide for renewal often require, as a condition of renewal, that the franchisee agree to the terms of the franchise agreement in use by the franchisor at the time of renewal.[171] A franchisee contemplating a renewal or extension of a franchise agreement on different terms may have a valid interest in reviewing a current disclosure document. The revised terms will most often reflect the fact that a material change in the business, operations, capital or control of the franchisor or the franchise has occurred, and so disclosure will be required under the wording of the existing Acts in any event, but it is conceivable that this will not be the case. A franchisee whose territorial rights change in some respect, for example, may want an updated list of franchisee openings or closures or more recent franchisee contact information. In the Commission's view, the adoption of the FTC approach to disclosure, in addition to the existing Ontario, P.E.I., New Brunswick and Model Bill provisions, would ensure more thorough protection for franchisees contemplating a renewal or extension of their franchise agreement.

A further point relates to the requirement for "no interruption in the operation of the franchisee's business". As Sotos and Trebilcock point out, no starting date or duration for the business interruption is specified.[172] A short business interruption, or one that occurred years in the past, is not likely to be relevant to whether disclosure should be provided.

RECOMMENDATION 40

The Act should require franchisors to provide a current disclosure document to a franchisee considering a renewal or extension of a franchise agreement where:

- ***there has been an interruption in the operation of the franchise exceeding a total of 60 days within the 24 months immediately preceding the renewal or extension;***
- ***a material change has occurred since the latest franchise agreement, renewal or extension was signed; or***
- ***the new agreement contains terms and conditions that differ materially from the most recent franchise agreement, renewal or extension.***

6. Additional Franchises

All Acts provide that disclosure is not required when an additional franchise is granted to an existing franchisee, if the new franchise is substantially the same as the existing franchise and if there has been no material change since the existing franchise agreement, renewal or extension. Again, an existing franchise would be presumed to have sufficient information about the franchise and the franchisor and to be fully aware of the risks. As well, in many cases, some material change will have occurred since the most recent franchise agreement, and so the exemption will not be available. Sotos and Trebilcock observe, however, that the statutes require no minimum amount of operating experience, and that some franchisors encourage poorly

[171] See *Timothy's Coffees of the World Inc. v. Switt*, [1996] O.J. No. 2398 (QL) (Gen. Div.).

[172] Sotos and Trebilcock, "Exemptions and Exclusions", *supra* note 30 at 13.

performing and vulnerable franchisees to open additional outlets to take advantage of economies of scale.[173]

The Commission considers that the principles applicable to the renewal of a franchise are equally relevant to the grant of an additional franchise. Disclosure should be required when there has been a significant interruption in the operation of the franchise within the preceding two years or where the new agreement contains materially different terms and conditions.

RECOMMENDATION 41

The Act should require franchisors to provide a current disclosure document to a franchisee considering an additional franchise agreement where:

- ***there has been an interruption in the operation of the existing franchise exceeding a total of 60 days within the 24 months immediately preceding the additional agreement;***
- ***a material change has occurred since the latest franchise agreement, renewal or extension was signed;***
- ***the additional agreement contains terms and conditions that differ materially from the most recent franchise agreement, renewal or extension; or***
- ***the additional franchise is not substantially the same as the existing franchise.***

7. Exemption by Regulation

The Alberta and New Brunswick Acts provide broad authority for regulations to be made to provide for exemptions from any or all provisions of the Act or regulations. The Ontario and P.E.I. Acts are more specific, authorizing regulations to be made exempting certain franchisors from the requirement to include financial statements in a disclosure statement. As well, under the P.E.I. Act, any franchisor may apply to the Minister for an exemption from the requirement to disclose financial statements. The Minister may exempt the franchisor, subject to any terms and conditions, if satisfied that to do so would not be prejudicial to the public interest. The Model Bill does not provide for exemptions to be made by regulation.

Alberta, Ontario and P.E.I. have made regulations to exempt certain franchisors from the requirement to include financial statements.

> This financial disclosure is a very sensitive topic – most franchisors are wary to disclose sensitive financial information in the form of financial statements required to be provided as part of the disclosure document. To avoid disclosing the financial statements of their operating companies, many franchisors incorporate sparsely detailed separate companies

[173] Sotos and Trebilcock, "Exemptions and Exclusions", *supra* note 30 at 9.

solely to act as the "franchisor" in a franchise relationship.[174]

In Alberta and Ontario, the exemptions apply if the net worth of the franchisor is at least $5 million (or $1 million if controlled by a corporation with a net worth of $5 million), it has at least 25 franchisees operating for the preceding five years in Canada (or in Ontario, in another single jurisdiction), and it has engaged in the franchise's line of business continuously for not less than the preceding five years. Ontario adds the requirement that the franchisor, its associates, directors, general partners or officers must not have had a judgment against them in the preceding five years relating to fraud, unfair or deceptive trade practices or a law regulating franchises.

The P.E.I. regulations set the same requirements as those in Ontario, except that the $5 million net worth requirement has been reduced to $2 million. The exemptions in all jurisdictions are made by self-assessment; an application to government is not required. However, the P.E.I. Act has an additional provision allowing any franchisor to apply to the Minister for an exemption from the requirement to include financial statements in the disclosure document. The Minister may exempt the franchisor, subject to any terms and conditions, if satisfied that to do so would not be prejudicial to the public interest.

The regulations made in Alberta, Ontario and P.E.I. apply to "mature franchisors".[175] Mature franchisors may be expected to provide more stable business opportunities, and to be reluctant to reveal sensitive information to their competitors. On the other hand, long established businesses can encounter financial difficulties, and it is arguable that all information relevant to the purchase of a franchise should be fully disclosed to prospective franchisees.

The consultation paper asked whether it would be appropriate to authorize exemptions to be made from the requirement to provide financial statements or from other requirements of the legislation or regulations. The responses were mixed. Some supported the concept of a large franchisor exemption:

> The rationale behind the exemption is that a franchisor with more than 25 stores and a net worth of more than $5 million would have a proven track record with its franchisees (both in terms of financial wherewithal as well as franchisee relations).
>
> Our position is that large franchisors, such as Tim Hortons, have created a successful formula and a positive relationship with their franchisees, and that the inclusion of financial statements in their respective disclosure documents would be prejudicial from a

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[174] Jones and So, *supra* note 24 at 34.

[175] Note that the Ontario Act also provides an exemption for disclosure to a "sophisticated franchisee"; one who invests $5 million in a one year period: *Ontario Act*, *supra* note 1. This exemption has not been included in other legislation, and "the exemption under the Ontario Act has proven to be problematic as it is uncertain how the term "invest" is to be interpreted": Frank Zaid and Dominic Mochrie, "Canada – A Comparison of Canada's Newest Franchise Legislation Against Existing Franchise Laws" (Paper presented to Today's Canadian Franchise Lawyer – Practising Locally in a Global Industry: 7th Annual Franchising Conference, Ontario Bar Association, November 15, 2007) at 14.

competitive perspective.[176]

Another respondent stated that "the Alberta, Ontario and P.E.I. approaches to these matters is appropriate for Manitoba",[177] noting that if a large franchisor who qualifies for the exemption is experiencing significant financial difficulties, this might fall under the requirement to disclose all material facts in any event.

Another submission supported the exemptions, but with the provision that a franchisee may still demand financial statements, subject to a confidentiality agreement:

> [I]t is clear that only those franchisors who are so large and well established that very little doubt may exist as to their financial status will be exempt from delivering financial statements. This means that a franchisee will still be able to make an informed decision, knowing that no disclosure document was provided because of the franchisor's size. However, if Manitoba were to incorporate this exemption, a provision should be added allowing a franchisee to still demand financial statements. If the franchisee is required to invest a very large sum in order to acquire the franchise, s/he should be able to consider the company's financial situation … the franchisee may be required to sign a confidentiality agreement that the financial statements will not be disclosed to anyone outside the franchise, thus successfully protecting such sensitive information.[178]

Others noted that the issue of possible exemptions for mature franchisors is a "sensitive and contentious issue".[179]

> There have been significant examples over the years of franchisors who might be considered to be "mature franchisors" who have subsequently encountered financial difficulties. There is no reason why a prospective franchisee should be prejudiced by not having financial information available to it.[180]

Similarly, another respondent stated:

> Just because a company is large doesn't mean that it is ethical or solvent. I have no problem with exemptions with respect to financial statements for companies that are publicly listed, as their financial statements are available from other sources. Franchisors rely on the confidentiality provisions in their franchise agreements with respect to trade secrets, procedures, etc. Why cannot franchisors rely on confidentiality agreements with respect to their financial statements? … In many situations where exemptions are allowed, the body granting exemptions, over the course of time, tends to act in the

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[176] Submission by the TDL Group Corp. (Tim Hortons) (July 31, 2007) at 1.

[177] Submission by E. Levitt (July 19, 2007) at 2.

[178] Submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007) at 25. The submission also supported a general provision authorizing the Minister to, by regulation, exempt any person, class of persons, sale of a franchise, class of sale of a franchise, franchise or class of franchise from any or all provisions of the Act or regulations, if satisfied that to do so would not be prejudicial to the public interest, subject to the terms and conditions that the Minister considers appropriate.

[179] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 7.

[180] *Ibid*.

> interests of industry (franchisors) rather than franchisees. Franchisors will appear before the exempting bodies repeatedly and a relationship inevitably develops between the franchisor applicant and the determining body.[181]

There are also distinctions as to how an exemption might be granted. As noted, the Ontario, Alberta, P.E.I. and New Brunswick Acts each authorize regulations to be made to provide generally for franchisor exemptions. However, under the P.E.I. Act, a franchisor also may apply individually to the Minister for an exemption from the requirement to disclose financial statements. The Minister has the discretion to order, if satisfied that to do so would not be prejudicial to the public interest, that the franchisor is exempt from the requirement to include prescribed financial statements in a disclosure document, subject to the terms and conditions set out in the order. One submission opposed such a provision:

> With respect to the possible inclusion in franchise legislation of the ability of a Minister to grant an exemption to a franchisor from disclosure requirements, we do not believe that such a procedure is appropriate or necessary. Discretionary authority can ultimately lead to inconsistent rule making, and in extreme cases prejudicial bias in favour of a particular franchisor. If franchise legislation is recommended in the nature of disclosure legislation without governmental filing or review, there should be no ability of the government to become involved in the private contracting process by issuing specific exemptions on a discretionary basis.[182]

The Canadian Franchise Association similarly opposes discretionary exemptions.[183]

On balance, the Commission is not persuaded that "mature franchisors" are immune from financial or ethical difficulties, or that there are principled reasons for providing for such exemptions. A business that intends to franchise must be aware that the franchise model inherently requires transparency. It is essential to the franchise relationship that the prospective franchisee understand the financial health of the franchisor before making a large investment and long term commitment. The Commission recommends that the Manitoba Act not provide authority to make such regulations.

RECOMMENDATION 42

The Act should not authorize regulations to be made to provide for exemptions from requirements of the Act or regulations.

[181] Submission by A.L. Weinberg (July 18, 2007) at 6.

[182] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 7.

[183] Submission by the Canadian Franchise Association (July 30, 2007).

H. DISCLOSURE REMEDIES

Canadian franchise statutes provide remedies for franchisees where a franchisor fails to comply with the disclosure requirements. Under the Acts, franchisees have a right of rescission and a right of action for damages.

If no disclosure was provided, a franchisee may rescind the franchise agreement within two years. A franchisee may rescind within 60 days if the franchisor failed to provide the disclosure document within the time required, or, under all Acts except Alberta's, if the contents did not meet the statutory requirements.

On rescission, the franchisor must compensate the franchisee for any net losses incurred in acquiring, setting up and operating the business. All Acts except Alberta's also require the franchisor to refund money received from the franchisee and to buy back any remaining supplies, equipment and inventory at a price equal to the purchase price paid by the franchisee.

The courts have considered the circumstances in which disclosure is so incomplete as to become "no disclosure", so that the two year rescission period applies. In *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd*.,[184] the franchisor had provided 70% of the information required, in several documents presented at different times. The Ontario Court of Appeal found that, rather than constituting incomplete disclosure, information provided at multiple times in multiple documents was "no disclosure" under the Act, and the franchisee was entitled to a two year rescission period. Similarly, the provision of a U.S. UFOC disclosure document rather than the document required under the Act has been found to be "no disclosure".[185]

The Ontario Court of Appeal has held that a franchisee's right to rescind is not conditional on his or her conduct, although a franchisor may have a separate right to pursue an action under the common law principles preserved by the Act.[186] A purchaser of a franchise in a transaction that has not yet closed has also been held to be a "franchisee" entitled to rescission for non-disclosure under the Ontario Act.[187]

The Acts also provide a right of action for damages, if a franchisee suffers a loss because of the franchisor's failure to comply with the disclosure requirements or because of a misrepresentation in the disclosure document or statement of material change. In Alberta, the right of action is against the franchisor and every person who signed the disclosure document or statement. The other Acts add to this list the franchisor's broker and the franchisor's associate

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[184] (2005), 256 D.L.R. (4th) 451 (Ont. C.A.) [*Dig This Garden*].

[185] *1518628 Ontario Inc. et. al. v. Tutor Time Learning Centres, LLC*, [2006] O.J. No. 3011 (QL) (S.C.J.); leave to appeal granted [2006] O.J. No. 4992 (QL) (Div. Ct.).

[186] *Personal Service Coffee Corp. v. Beer (c.o.b. Elite Coffee Newcastle)* (2005), 256 D.L.R. (4th) 466 (Ont. C.A.) [*Personal Service Coffee Corp.*].

[187] *Bekah v. Three For One Pizza* (2003), 67 O.R. (3d) 305 (S.C.J.); see also *1368741 Ontario Inc. v. Triple Pizza (Holdings) Inc.*, [2004] O.J. No. 3562 (QL) (C.A.), aff'g [2003] O.J. No. 2097 (QL) (S.C.J.).

(Ontario also adds the "franchisor's agent").[188]

The franchisee is not required to show reliance on the information. The franchisee is deemed to have relied on the misrepresentation, or, where the franchisor failed to provide a statement of material change, on the information in the disclosure document.

A person will not be liable if he or she proves that the franchisee acquired the franchise with knowledge of the misrepresentation or material change. As well, a person other than the franchisor has various other grounds of defence; for example, that he or she did not know that the document was given to the franchisee and gave written notice to the franchisee promptly on becoming aware that it had been given, or that, with respect to any part purporting to be made on the authority of an expert, the person had no reasonable grounds to believe and did not believe that there had been a misrepresentation or the part did not fairly represent the opinion of the expert.

The ULCC Model Bill and the P.E.I. Act add two more grounds of defence. A person other than a franchisor will not be liable for misrepresentation if the misrepresentation was made on the authority of a public official, subject to certain conditions, or if he or she conducted an investigation sufficient to provide reasonable grounds for believing that there was no misrepresentation and believed that there was no misrepresentation. The latter defence appears to be based on the due diligence defence under securities law. [189]

The Ontario Court of Appeal has held that a franchisee may be entitled to receive both the remedy of rescission and an award of damages under the Act.[190] As well, in *Khachikian v. Williams*, the court awarded punitive damages, to reflect the "court's denunciation of what the defendant did and [to] serve as a deterrent to others who might also be inclined to use the concept of franchising as a means of taking undue and improper advantage of another person".[191]

As noted earlier, the franchise statutes also preserve remedies otherwise available to the parties; the rights under the Acts are in addition to any other right or remedy a party to a franchise agreement may have at law. As a result, a franchisee may seek damages or remedies

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[188] The term "franchisor's agent" in Ontario was originally not defined, which created some interpretation problems and was thought to expose third party advisors to liability. Under amendments to the Ontario regulation made in 2004, a franchisor's agent is now defined as "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"; *Ontario Regulation*, *supra* note 56, s.0.1 as am. by O. Reg. 69/04, s.1. See ULCC, *Uniform Franchises Act Working Group Commentary*, *supra* note 23 at 18.

[189] See Shawn H.T. Denstedt and Scott R. Miller "Due Diligence in Disclosing Environmental Information for Securities Transactions" (1995) 33 Alta. L. Rev. 231 for a discussion of disclosure requirements and the due diligence defence for misrepresentation in the securities law context.

[190] *Dig This Garden*, *supra* note 184. This decision and other aspects of the Ontario Act have been criticized by the lawyer who represented the franchisor in *Dig This Garden*: see Natalie Fraser, "Opinion split on act's protection of franchisees" *Law Times* (March 6, 2006) at 13, online: <http://siskinds.com/pdfs/Mar_6_06_reprint_Law_ Times.pdf>; Shawn Graham, "Statutory Rescission: Where's The Equity?" *Siskinds Collection of Franchise Law Articles* (FRAN/RP-022, March 15, 2006) (QL).

[191] [2003] O.J. No. 5876 at para. 23 (QL) (S.C.J.).

such as rescission or relief against forfeiture under general contract law or tort law principles,[192] and the limitation periods set out in the statutes do not apply.

It is important to recognize that the principles that have developed to govern the remedies generally available at law will not always be directly transferable to the statutory franchise remedies. For example, in the leading misrepresentation case in Manitoba, the Court of Appeal held that a claim for rescission for misrepresentation in the sale of land was barred when the purchaser affirmed the contract by remaining in possession of the premises after discovery of the misrepresentation.[193] However, in *Dig this Garden*,[194] the Ontario Court of Appeal held that this principle does not apply in the case of statutory rescission. The franchisee had continued to carry on business for 3 ½ months after serving the notice of rescission, but the court held that the continued possession did not affect the rescission right. As of the date of statutory rescission, there was no longer a contract capable of being affirmed; to hold otherwise would negate the rescission remedy provided by the Act. The court noted as well that it was preferable for the franchisee to conduct an orderly winding down of the business and in doing so the franchisee could not be said to have affirmed the agreement that is rescinded by operation of law. Finally, the court also held that section 11 (which provides that any purported waiver by a franchisee of a right under the Act is void) is sufficiently broad to cover the situation where it is alleged that a franchisee has by conduct affirmed the agreement and waived the statutory right to rescission.

Subject to our comments below, the Commission is satisfied that the remedies set out in the existing statutes (including the additional grounds of defence to misrepresentation included in the Model Bill), and the preservation of existing common law rights and remedies, are appropriate, and recommends consistency with the Model Bill.

RECOMMENDATION 43

The Act should include the provisions contained in the Model Bill with respect to the disclosure remedies available to franchisees.

RECOMMENDATION 44

The Act should preserve the rights and remedies that the parties to a franchise agreement may otherwise have at law.

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[192] See, for example, *Machias v. Mr. Submarine Ltd*., *supra* note 117: the Ontario Act did not apply, as the franchise was operated in Quebec. However, the court found that the franchisor's pre-contractual verbal and written representations constituted fraudulent misrepresentation, and that the governing agreement's exclusionary clauses could not be enforced when the franchisor had engaged in unconscionable conduct. The franchise agreement was rescinded.

[193] *Andronyk v. Williams* (1985), 36 Man. R. (2d) 161 (C.A.).

[194] *Supra* note 184.

1. Misrepresentation and Future Projections

No concerns were raised with the Commission about the remedies set out in the Canadian statutes, and as noted, the Commission agrees that the remedies are appropriate and that consistency with the Model Bill should be maintained. However, one clarification is necessary in relation to the remedy of damages for misrepresentation in a disclosure document or statement of material change. In the Commission's opinion, some ambiguity may exist as to whether the statutory remedy of damages for misrepresentation is available for statements of future projection and forecasts. There is some uncertainty in this area of the law in Manitoba, and while the development of the law in relation to the statutory remedies may in time resolve the ambiguity, it would be preferable to clarify this point.

The definition of "misrepresentation" in the ULCC Model Bill is as follows:

> "misrepresentation" includes,
>
> > (a) an untrue statement of a material fact, or
> > (b) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made.

As discussed earlier, "material fact" means any information about the business, operations, capital or control of the franchisor, franchisor's associate, franchise or franchise system that would reasonably be expected to have a significant effect on the value or price of the franchise or the decision to acquire the franchise.

The use of the word "includes" in the definition of misrepresentation implies that a misrepresentation may extend beyond the examples in paragraphs (a) and (b). However, as we observed in our 1994 Report, *Pre-contractual Misstatements*, the law relating to pre-contractual mis-statements "is quite extraordinarily complex and confusing and is productive of inconsistent results".[195] If common law principles are applied, the statutory remedy of damages may not be available for pre-contractual representations by the franchisor that extend beyond statements of existing fact to future events (such as earnings projections or other financial performance representations, for example).

Outside of legislation, the remedies available to a franchisee who has suffered a loss as a result of misrepresentation are limited. A common law action for misrepresentation may be founded in contract or in tort. Under contract law principles, a pre-contractual misrepresentation does not give rise to a claim for damages unless the representation can be interpreted as a promise that amounts to a contract term or warranty. Alternatively, a contract induced by a misrepresentation of existing fact is voidable and may be rescinded.[196] Under tort principles, the remedies are more flexible; rescission and damages are available under the tort of negligent misrepresentation. However, in *Andronyk v. Williams*, the Manitoba Court of Appeal concluded

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[195] Manitoba Law Reform Commission, *Pre-contractual Misstatements* (Report #82, 1994) at 1.

[196] But not one induced by a statement of law, an opinion or "puffery": *ibid.*

that misrepresentation in tort is to be interpreted as it is in contract law, and representations of future prospects or expectations are not actionable under either category.[197] An action for misrepresentation in either tort or contract law must be founded on a statement of existing fact.[198]

The distinction between a representation of future prospects and a representation of existing facts is not always obvious. In *Foster*, Huband, J.A. stated in relation to a tort claim:

> … a statement of intention or forecast of the future may contain, by implication, the representation that the author believes his statement to be true, and that there is a present or past factual foundation for the belief. For this reason, the relationship between the person who makes a representation and the person who acts upon it to his detriment is critical both to determine whether there is a duty of care and in deciding the nature of the implicit factual foundation underlying a forecast of the future. It would be one thing for a chartered accountant who had examined the books of Assiniboia Downs 1981 Ltd. to express confidence that the racing season would proceed in a normal fashion to a group of worried creditors, for his forecast would necessarily relate to his examination of the financial stability of the company. It is quite a different matter when the chairman of the Horse Racing Commission says the same words to a group of sports enthusiasts, for in his case the expression of confidence may relate to contingency plans in the event that the current operator of the track becomes bankrupt.[199]

In franchise negotiations, the relationship between a franchisor and prospective franchisee may provide a strong case for finding an implicit factual foundation underlying a franchisor's forecast of the future. If so, at common law, the franchisor's representation of future events may contain by implication the representation that the franchisor believes the statement to be true and that there is a factual foundation for the belief, so that an action in contract or in tort may be founded. However, this may not always be the case.

The Commission recommended in 1994 that the definition of misrepresentation be broadened under proposed legislation, to provide greater protection for the misrepresentee. The Commission proposed

> that misrepresentation include a misrepresentation of law and statements which have a capacity to induce reasonable reliance and do induce such reliance. … This will permit a more direct and simple approach and may assist a court in fashioning a remedy in a case such as *Andronyk v. Williams* where traditional rules failed to provide a remedy for a deserving misrepresentee. We recognize that the proposed definition of misrepresentation will include statements of opinion and forecasts. We hasten to underline, however, that such statements must have the capacity to induce reasonable reliance and must be relied on by the misrepresentee. [Emphasis in original.]

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[197] *Andronyk v. Williams*, *supra* note 193; *Foster Advertising Limited v. Keenberg and Manitoba* (1987), 45 Man. R. (2d) 1 (C.A.), leave to appeal refused, [1987] S.C.C.A. No. 177 (QL) [*Foster Advertising*].

[198] The Supreme Court of Canada has also assumed, without deciding, that this view of the law is correct: *Queen v. Cognos Inc*., [1993] 1 S.C.R. 87.

[199] *Foster Advertising*, *supra* note 197 at 11; see also *Jacks v. U & R Tax Services Ltd*. (1995), 107 Man. R. (2d) 78 (C.A.).

In the Commission's view, franchise legislation in Manitoba should provide clearly that the remedy of damages for misrepresentation under the Act applies to misrepresentations involving future projections and forecasts, to avoid any uncertainty on this point.[200] The Commission supports the provisions in existing Canadian franchise legislation that deem a franchisee to have relied on a misrepresentation. As a result, the comments in our 1994 report with respect to the need for reliance to be demonstrated do not apply in this context.

As noted earlier, recent amendments to the Manitoba *Securities Act*[201] and to other Canadian securities statutes address the representation of future events. The Manitoba Act includes a very similar definition of "misrepresentation" to Canadian franchise legislation, and similarly provides for an action for damages for misrepresentation. Amendments enacted on November 8, 2007 add the following definition of "forward-looking information":

> "forward-looking information" means disclosure regarding possible events, conditions or results of operations that is based on assumptions about future economic conditions and courses of action, and includes future-oriented financial information with respect to prospective results of operations, financial position or cash flows that is presented either as a forecast or a projection.[202]

The amendments provide a defence to an action for misrepresentation in forward-looking information, if the person proves that the document containing the information contained reasonable cautionary language identifying the forward-looking information as such and identifying the material factors that could cause actual results to differ materially, as well as a statement of the material factors or assumptions applied. As well, the person must have had a reasonable basis for drawing the conclusions or making the forecasts or projections. Earlier in this chapter, we recommended that the disclosure requirements for financial performance representations include similar language. In the Commission's view, it would also be appropriate to provide for a defence to an action for misrepresentation based on future projections and forecasts where the requirements of the regulations are met.

RECOMMENDATION 45

The Act should provide that the statutory remedy of damages for misrepresentation applies to future projections and forecasts.

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[200] While these are similar accounting concepts, ""projections" are future-oriented outcomes which are reasonably possible, while a "forecast" is the single future-oriented outcome which management believes to be the most probable outcome": W. David Sanderson and Arthur Trebilcock, "Earnings Claims and the *Arthur Wishart Act*: The Accountant's Perspective" 1:1 *Canadian Franchise Review* 6 at 8, n.2, online:<http://www.lexisnexis.ca/documents/sample_franchise_review.pdf>.

[201] *Supra* note 40.

[202] *The Securities Amendment Act*, *supra* note 87, s. 2(1).

RECOMMENDATION 46

The Act should provide that a person is not liable in an action under the Act for misrepresentation in a future projection or forecast if:

- ***the disclosure document contained the information required by the regulations, including reasonable cautionary language identifying the representation as a future projection or forecast and identifying material factors that could cause actual results to differ materially; and***
- ***the person had a reasonable basis for making the projection or forecast.***

2. Additional Remedies

The Commission received some suggestions as to additional franchisee remedies that might be considered. For example, a suggestion was made for an expanded right of rescission following mandatory arbitration for specific disputes based on breaches of disclosure or franchisor performance obligations that are primarily questions of fact (for example, disputes as to whether training was provided as promised). In addition, Manitoba legislation might address situations in which a franchisor fails to enforce system wide rules in relation to a franchisee (for example, standards of cleanliness and uniformity). In these circumstances, other franchisees may suffer damages from the franchisor's inaction, but have no remedy. Legislation could provide that affected franchisees are entitled to withhold royalty payments for a period of time, as determined by agreement between the franchisor and franchisee, by binding arbitration or by another mechanism.[203]

The Commission is not prepared to recommend that additional remedies be included in Manitoba legislation at this time. As experience is gained with the remedies available under franchise regulation in Manitoba, revisions may prove to be necessary, but until that time the Commission prefers to maintain consistency with other Canadian jurisdictions.

I. DUTY OF FAIR DEALING (GOOD FAITH)

The Ontario and Alberta Acts provide that every franchise agreement imposes on each party a duty of fair dealing in the performance and enforcement of the agreement. The Model Bill and the P.E.I. and New Brunswick Acts each have a similar provision, but also provide that the duty applies to the exercise of a right under the agreement. As a result, parties must consider the duty of good faith even if exercising a discretionary right or an option provided for by the

[203] Submission by A.L. Weinberg (July 18, 2007).

agreement.[204] None of the Acts impose a duty of fair dealing in the negotiation of an agreement.

All Acts except Alberta's provide that a party has a right of action for damages against another party who breaches the duty of fair dealing, and that the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards. All Acts also provide that the duty of fair dealing applies retroactively to franchise agreements entered into before the legislation came into force. As well, all Acts also preserve the rights and remedies that the parties to a franchise agreement may otherwise have at law.

The courts have had some opportunity to consider the good faith requirement. The Ontario Superior Court of Justice has held that a franchisor was entitled to favour one feuding co-franchisee in a buyout of the other co-franchisee in the interests of the overall franchise,[205] and that the duty of good faith applies to the franchisee as well as to the franchisor.[206] In *Personal Service Coffee Corp.,* the Ontario Court of Appeal held that the statutory duty of fair dealing does not apply once the franchisee has rescinded the agreement, since the duty only applies to the performance and enforcement of an agreement that is still in effect (however, remedies may be available at common law).[207]

In *Sobeys*,[208] the Ontario Superior Court of Justice held that the duty under the Ontario Act extended only to the performance and enforcement of existing agreements; it did not require the franchisor to renew an expiring lease agreement that it considered to be commercially unreasonable, in the absence of an option to renew. Instead, the franchisor was entitled to secure the lease for itself. Similarly, in *TDL Group Ltd. v. 1060284 Ontario Ltd.*,[209] a franchisor was not required to provide a reason for declining to renew a 10 year franchise agreement where the agreement included no provision for renewal. On the other hand, another franchisor breached its duty of good faith when it failed to award a new competing franchise location to an existing franchisee who was in good standing and whose location was no longer viable, even though the

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[204] Zaid and Mochrie, *supra* note 175: the authors explain that "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" at 13. The ULCC Uniform Franchises Act Working Group reported that the words "including in the exercise of a right" were added "because the duty of fair dealing incorporating the duty of good faith and commercial reasonable standards in the Ontario Act does not extend to express contractual provisions granting the franchisor discretionary authority over rights to be exercised during the term of the contract that may be carried out without regard to fair dealing": ULCC, *Uniform Franchises Act Working Group Commentary*, *supra* note 23 at 9.

[205] *Country Style Food Services Inc. v. Hotoyan*, [2001] O.J. No. 2889 (QL) (S.C.J.); see also *Mr. Submarine Limited. v. Sowdaey*, [2002] O.J. No. 4401 (QL) (S.C.J.) (the duty of good faith did not require the franchisor to put the franchisee's interests ahead of its own).

[206] See *Gerami v. Double Double Pizza Chicken Ltd*., [2005] O.J. No. 5252 (QL) (S.C.J.).

[207] *Personal Service Coffee Corp., supra* note 186.

[208] *530888 Ontario Ltd. v. Sobeys Inc*., *supra* note 103.

[209] *TDL Group Ltd. v. 1060284 Ontario Ltd*., *supra* note 103; B. Wright, J. observed that "[w]hen a party enters into an agreement which contains no right to renew or an option to renew on ascertainable terms there will be no renewal enforceable by a court" at para. 17.

franchisor's action was not barred by the franchise agreement.[210]

There appears to be no duty to inform the other party of its obligations; a franchisee who was aware of the franchisor's obligations to provide disclosure and who failed to inform the franchisor was held not to have breached the duty of good faith.[211]

Respondents to the consultation paper did not report concerns with the fair dealing/good faith provisions. In the Commission's opinion, the statutory provisions essentially codify the common law duty of good faith in the franchise context.[212] Certainly, it would be anomalous to choose to enact legislation in Canada that did not include the duty of fair dealing / good faith. The Commission is satisfied that the existing provisions set a reasonable standard, and that consistency with the Model Bill is appropriate for Manitoba.

RECOMMENDATION 47

The Act should impose on parties to a franchise agreement a duty of fair dealing in the performance and enforcement of the agreement, including in the exercise of a right under the agreement, as provided in the ULCC Model Bill. The duty should include the duty to act in good faith and in accordance with reasonable commercial standards. The Act should provide for a right of action for damages by a party to a franchise agreement against another party who breaches the duty of fair dealing.

J. RIGHT TO ASSOCIATE

The Canadian franchise statutes and the ULCC Model Bill each provide that a franchisee may associate with other franchisees and may form or join an organization of franchisees. A franchisor may not prohibit or restrict a franchisee from doing so (or, except in Alberta, interfere with a franchisee), or directly or indirectly penalize or threaten to penalize a franchisee for exercising this right. All statutes except Alberta's provide that a provision in an agreement purporting to restrict a franchisee from exercising this right is void. All Acts provide that a franchisee has a right of action for damages against a franchisor that contravenes this provision.

All Acts provide that the right to associate applies retroactively to franchise agreements entered into before the legislation came into force.

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[210] *Katotikidis v. Mr. Submarine Ltd*. (2002), 26 B.L.R. (3d) 140; 29 B.L.R. (3d) 258 (Ont. S.C.J.) the court found that the Ontario Act duty did not apply to events that occurred before the Act came into force, but awarded damages, including punitive damages, based on the common law duty of good faith.

[211] Even assuming that the duty of good faith existed before the execution of the franchise agreement: *Payne Environmental Inc. v. Lord and Partners Ltd*. (2006), 14 B.L.R. (4th) 117 (Ont. S.C.J.).

[212] See *Machias v. Mr. Submarine Ltd*. *supra* note 117; *Country Style Food Services Inc. v. Hotoyan*, *supra* note 205. Zaid notes that the term "reasonable commercial standards" can be seen to extend the general meaning of good faith, in that parties must be objectively reasonable in the performance of their duties: Zaid, *Franchise Law*, *supra* note 25 at 319.

The Australian Franchise Code Review Committee recommended in 2006 that the *Franchising Code of Conduct* be amended to prohibit franchisors from inducing prospective franchisees (as well as current franchisees) not to associate with current or past franchisees. The Committee had received submissions indicating that franchisors had exerted pressure on prospective franchisees not to communicate with past franchisees, and considered that "the interests of current or past franchisees cannot be distinguished from those of prospective franchisees in this respect". [213]

The current Canadian franchise statutes do not prohibit franchisors from interfering with prospective franchisees in relation to their communications with current or past franchisees. They also do not prevent franchisors from prohibiting or restricting current franchisees from communicating with prospective franchisees, from interfering with these communications or from penalizing current franchisees who communicate with prospective franchisees. In the Commission's view, franchise legislation should ensure that there are no obstacles to prospective franchisees' communications with current and past franchisees.

RECOMMENDATION 48

The Act should protect the right of franchisees to associate with other franchisees and to form or join an organization of franchisees, in a manner consistent with the ULCC Model Bill. The Act should contain provisions consistent with the Model Bill to:

- ***prohibit franchisors from penalizing or interfering with franchisees who exercise the right to associate;***
- ***provide that a provision in an agreement purporting to restrict a franchisee from exercising the right is void; and***
- ***provide that a franchisee has a right of action for damages for a contravention of the prohibition.***

The Act should also prohibit franchisors from interfering with communications between prospective franchisees and current or past franchisees. With respect to current franchisees, the right to associate should apply retroactively to franchise agreements entered into before the Act comes into force.

K. WAIVER OF RIGHTS

All Acts provide that any waiver or release by a franchisee of a right or requirement under the Act or regulations is void. The P.E.I. and New Brunswick Acts and the Model Bill also extend this provision to prospective franchisees. Under all Acts except Alberta's, this

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[213] Austl., Commonwealth, Franchising Code Review Committee, *Review of the Disclosure Provisions of the Franchising Code of Conduct*: *Report to the Hon Fran Bailey, Minister for Small Business and Tourism* (Canberra: Secretariat, Office of Small Business, October 2006) at 42, online: <http://www.innovation.gov.au/Section/SmallBusiness/Documents/Franchising_Code_Review_Report_2006_FINAL_06120720070205134250.pdf> [Franchising Code Review Committee].

applies retroactively to franchise agreements entered into before the legislation came into force.

There has been little case law on the waiver of rights. In *1518628 Ontario Inc. v. Tutor Time Learning Centres*,[214] however, the Ontario Superior Court of Justice held that the statutory prohibition on the waiver of rights does not apply to a settlement of a claim arising from the right of rescission. The settlement of a claim arising from the right is not itself a waiver of the right of rescission:

> In my view, if a franchisee, as in the instant situation, with full knowledge of a breach of the franchiser's obligations to disclose as required by the *Act* and regulations, and with the benefit of independent legal advice, chooses to affirm the franchise agreement as a settlement of the claims that arise from the franchiser's breach, then the franchisee can no longer rescind and make a claim to the remedies afforded by s. 6(6) of the *Act*. [215]

On the other hand, a release may be obtained under unconscionable circumstances. In *B.B.J Enterprises Ltd. v. Wendy's Restaurants of Canada Inc*.,[216] the franchisor insisted that the franchisee sign a release of future claims in the last minutes of negotiations for the purchase of the assets of a failing franchise. The court noted that the franchisor was well aware that the franchisee felt entitled to money in excess of the asset purchase amount for the reimbursement of loans but that his financial situation was desperate. The franchisor presented the franchisee with a release a half hour before closing "knowing that he would have little choice but to sign and so he did".[217] The court held that the release was unconscionable and was not a bar to the franchisee's later court action.

The Commission received no comments with respect to the waiver of rights. However, on balance, the Commission agrees with the court's reasoning in *Tutor Time*. There will be little opportunity for franchisors and franchisees inclined to settle their disputes to do so if the franchisee is unable to waive his or her rights in relation to the matter in dispute in return for other concessions. In the Commission's view, there is a distinction between a waiver of rights occurring before a dispute arises, such as when a franchise or lease agreement is signed, and a waiver of rights that may be given in the settlement of a dispute that later transpires. We recognize that there may be situations in which a franchisor attempts to gain unfair advantage, but the rights afforded and duties imposed under franchise legislation make the circumstances of *B.B.J. Enterprises Ltd*. less likely to arise, in particular because the parties will be held to the duty of fair dealing during settlement negotiations.

The Commission holds the view that, given the power imbalance inherent in most franchise relationships, a general statutory prohibition on the pre-dispute waiver of rights is sound. However, franchisees should have the ability to waive their rights in relation to a dispute

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[214] *Supra* note 185.

[215] *Ibid*. at para. 109.

[216] 2004 NSSC 37, 222 N.S.R. (2d) 52.

[217] *Ibid*. at para. 10. This case did not deal with the franchisee's statutory rights, as there is no franchise legislation in Nova Scotia.

that later arises in the context of a settlement agreement in respect of the dispute.[218] At that point, the duty of fair dealing applies and one can be more confident that the waiver is informed and voluntary; the franchisee is more likely to have obtained legal advice and to have a full understanding of his or her statutory rights, the consequences of the waiver and the benefits obtained in return.

RECOMMENDATION 49

The Act should provide that any pre-dispute waiver or release by a franchisee or prospective franchisee of a right or requirement under the Act or regulations is void. The provision should apply retroactively to franchise agreements entered into before the Act comes into force. The Act should allow franchisees to waive a right or requirement under the Act or regulations in relation to a dispute in the context of a post-dispute settlement agreement.

L. BINDING THE CROWN

The Canadian statutes take different approaches with respect to binding the Crown. The Ontario and P.E.I. Acts expressly exempt the Crown,[219] while the New Brunswick Act specifically binds the Crown. The Alberta Act and the ULCC Model Bill neither expressly exempt nor bind the Crown.

The drafters of the Model Bill reported that the Ontario exemption was not included because "there was no reasonable basis on which to exempt the Crown if it is in a business franchise relationship acting like a private sector entity".[220] The Model Bill and the New Brunswick Act do include a provision exempting the Crown from including the financial statements otherwise required in its disclosure document.

While it seems unlikely that the Crown would engage in franchising as it is generally understood, the Commission agrees that there is no principled reason to exempt the Crown from the requirements of the Act if the Crown engages in a commercial enterprise that falls within the

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[218] We note that Iowa's franchise legislation provides that a requirement that a franchisee waive compliance with a statutory right or relieve a person from a duty or liability imposed by the statute is void. However, this provision does not affect the settlement of disputes brought pursuant to the statute: Iowa Code §§ 523H.4. Similarly, the Australian Franchising Code provides that a franchise agreement may not contain a general release of the franchisor from liability toward the franchisee or a waiver of any verbal or written representation by the franchisor, but that this does not prevent the franchisee from settling a claim against the franchisor at a later time: *Franchising Code of Conduct*, *supra* note 71, Sch., s. 16.

[219] Subsection 2(3) of the Ontario Act provides that the Act does not apply to "a service contract or franchise-like arrangement with the Crown or an agent of the Crown", while subsection 2(4) of the P.E.I. Act provides more simply that the Act "does not bind the Crown": *Ontario Act*, *supra* note 1; *P.E.I. Act*, *supra* note 1. Note that the 'default' position in Manitoba, like Ontario, Alberta and New Brunswick (and unlike P.E.I.), is that the Crown is not bound by an Act unless the Act so expressly states: *The Interpretation Act*, C.C.S.M. c. I80, s. 49.

[220] ULCC, *Uniform Franchises Act Working Group Commentary*, *supra* note 23 at 9.

scope of franchise activity.[221] On the other hand, the exemption from the requirement to provide financial statements in the Model Bill and New Brunswick Act is a reasonable acknowledgement of the unique status of the Crown.

RECOMMENDATION 50

The Act should expressly bind the Crown, but exempt the Crown from including in its disclosure document the financial statements otherwise required by the Act.

M. JURISDICTION

All Acts provide that any provision in a franchise agreement that purports to restrict the application of the law of the province or to restrict jurisdiction or venue to a forum outside the province is void with respect to a claim otherwise enforceable under the Act in the province.

It is not unusual for franchise agreements to provide that the sole venue for the litigation or arbitration of disputes is a jurisdiction chosen by the franchisor, which may be another province or, in the case of U.S. based franchisors, a U.S. state. The Commission agrees that with respect to Manitoba franchises, the legislation should provide that a provision that purports to restrict the application of Manitoba law or to restrict jurisdiction or venue to a place outside Manitoba is void.

RECOMMENDATION 51

The Act should provide that any provision in a franchise agreement that purports to restrict the application of the law of Manitoba or to restrict jurisdiction or venue to a forum outside Manitoba is void with respect to a claim otherwise enforceable under the Act in Manitoba.

N. APPLICATION TO FARM EQUIPMENT DEALERS

Although no franchise legislation exists in Manitoba, certain ongoing commercial relationships are regulated. Legislation amending *The Farm Machinery and Equipment Act*,[222] governing farm equipment dealerships, was enacted in May 2000 to prohibit the practice of "dealer purity". Under the Act, a farm equipment manufacturer may not prevent a dealer from carrying competing equipment lines and products, discriminate among similarly situated dealers or terminate a dealership agreement without cause. In most cases, a court order is also required for termination. The Act also provides for the court to appoint a mediator to mediate disputes on

[221] For example, the Crown may engage in activities that fall within the definition of a franchise in the areas of driver licensing and lottery sales.

[222] C.C.S.M. c. F40, as am. by *The Farm Machinery and Equipment Amendment Act*, S.M. 2000, c. 22.

the request of one of the parties to the dealership agreement and requires the parties to participate in good faith.

The Commission received one submission with respect to the application of the Act to farm equipment dealerships. The Manitoba Farm Machinery Board advised the Commission that it is in general agreement with the concept of franchise legislation. The Board noted that it is not clear whether a dealer-vendor agreement under the *FMEA* would constitute a franchise agreement under existing franchise statutes,[223] but if franchise legislation would apply, it is the Board's view that the provisions of *FMEA* should remain unaffected. The Board considers that this would be achieved if Manitoba franchise legislation includes a provision similar to section 10 of the ULCC Model Bill, which provides that the rights conferred by or under the Act are in addition to and do not derogate from any other right or remedy a party to a franchise agreement may have at law.[224] The Commission agrees with this approach, and has recommended the preservation of other rights and remedies.

O. FRANCHISE RELATIONSHIP REGULATION

In addition to the disclosure requirements and franchisee remedies for non-disclosure, Canadian franchise legislation includes certain provisions that regulate the relationship between the parties to a franchise agreement. The provisions impose a duty of fair dealing on the parties to a franchise agreement and restrict the enforceability of certain terms that a franchisor might otherwise include in the agreement (a franchisor cannot restrict the franchisee's freedom to associate and cannot enforce a clause under which a franchisee purports to waive his or her rights under the Act).

Given the power imbalance between the parties to the franchise contract, the "take it or leave it" nature of most agreements, and the unilateral ability of a franchisor under many agreements to make fundamental changes to the operation of the franchise during the term of the contract and at its renewal, some jurisdictions place additional restrictions on the terms that a franchisor may include in an agreement or the changes that it may impose.[225] In the U.S., Bills have been introduced in Congress, but not enacted, proposing additional regulation. For example:

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[223] Farm machinery and equipment dealers do not as a rule pay fees or royalties to manufacturers or vendors for the right to distribute and sell a line of machinery or equipment: submission by the Manitoba Farm Machinery Board (October 29, 2007).

[224] Submission by the Manitoba Farm Machinery Board (October 29, 2007).

[225] An Australian review of the efficacy of disclosure provisions in franchise regulation concluded that the use of disclosure as the primary regulatory tool is inconsistent with the long term nature of the franchise contract and the nature of the relationship. Franchise contracts were analyzed in relation to goals such as balance of power, certainty and fairness of contract terms, and franchise contract terms did not appear to be consistent with those goals: Elizabeth C. Spencer, "The Efficacy of Disclosure in the Regulation of the Franchise Sector in Australia" (Paper presented at the Third Meeting of the European Network on the Economics of the Firm (ENEF), GREDEG, CNRS and University of Nice Sophia Antipolis, September 7, 2006), online: <http://www.enef.group.shef.ac.uk/2006%20workshop%20papers/SPENCER.pdf>.

> the Small Business Franchise Act of 1999 (H.R. 3308), proposed, among other things, a comprehensive scheme for regulating the franchise relationship and included provisions on contract terminations, and transfers; encroachment; the purchase of goods or services from designated sources of supply; and franchisees' rights to associate with other franchisees.[226]

As well, several U.S. states have enacted laws addressing matters such as the termination, renewal and transfer of the franchise, territorial encroachment, requirements for the purchase of goods and services from designated sources, franchisees' right to associate and forum selection.[227]

Iowa's legislation is recognized as being the most comprehensive in the U.S. and, among other things, prohibits franchisors from terminating or refusing to renew a franchise without good cause (or, in the case of renewal, unless certain circumstances exist, such as the franchisor's withdrawal from that market). It also prohibits franchisors from requiring franchisees to purchase goods or services exclusively from the franchisor or designated sources when comparable goods and supplies are available from other sources. A franchisee may transfer the franchise so long as the transferee satisfies the reasonable current qualifications of the franchisor for new franchisees, and the franchisor may not require, as a condition of the transfer, that the franchisee undertake obligations or relinquish rights unrelated to the franchise being transferred or enter into a release of claims that is broader than a release entered into by the franchisor. Franchisees also have a cause of action for damages if a franchisor allows encroachment that adversely affects the franchisee's sales.[228]

In Australia, the Franchising Code Review Committee recently recommended that consideration be given to prohibiting unilateral changes by franchisors and removing or modifying the right of a franchisor to terminate a franchise agreement unilaterally. The Committee added that if the right is maintained, adequate franchisee compensation should be required.[229] The Australian Government responded to this recommendation by amending the *Trade Practices Act 1974*.[230] The amendment does not prohibit unilateral changes or terminations by a franchisor, but provides that the fact that a supplier of goods and services has a contractual right to vary a term of a contract unilaterally is a factor that a court may consider when determining whether the supplier has engaged in unconscionable conduct in a business transaction.

The ability of the franchisor to impose unilateral changes to business operations was also identified as a concern by the American Franchisee Association, which has advocated for federal

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[226] U.S. General Accounting Office, *Federal Trade Commission: Enforcement of the Franchise Rule* (Report to Congressional Requesters, July 2001) at 40, online: <http://www.gao.gov/new.items/d01776.pdf>.

[227] *Ibid*. at 43-44.

[228] *Ibid.* at 44; Iowa Code §§ 523H.1-523H.17.

[229] Franchising Code Review Committee, *supra* note 213 at 26-27.

[230] *Trade Practices Act 1974* (Cth.), s. 51AC(3)(ja).

franchise relationship provisions.[231]

> [A] prospective franchisee may do his or her due diligence, investigate the system, talk to franchisees, and be comfortable in signing the current franchise agreement. ... [but] some of the unilateral changes to franchise relationships involve issues that no franchisee could have anticipated upon the initial signing of the contract. In other words … a franchisee may be bound by changes to the relationship that, had they known, they never would have signed the agreement in the first place.[232]

A contrary view to suggestions for additional restrictive provisions is that disclosure legislation reflects the right balance in the franchise relationship, and the freedom of the franchisor to exercise control over the operation of the business on an ongoing basis is necessary for the creation and maintenance of the business brand. Franchisor control and flexibility creates and adds value to the franchise identity, which is why franchisees invest in the franchise in the first place, and there is no "one size fits all" solution for disputes involving companies operating in a wide range of industries. As well, many obligations contained in franchise relationship regulatory proposals are ambiguous, creating uncertainty and potentially leading to increased litigation and increased costs. Comprehensive pre-sale disclosure and the ability to contact present and former franchisees ensure that the prospective franchisee is able to obtain the information necessary to determine the likelihood of disputes occurring within a specific franchise relationship.[233]

As well, unlike federal U.S. regulation and Australia, Canadian jurisdictions have incorporated a standard of conduct, the duty of fair dealing, in their legislation.[234] In fact, it has

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[231] The American Franchisee Association proposed a *Model Responsible Franchise Practices Act* in 1996; see The American Franchisee Association, *Who Are We?,* online: <http://www.franchisee.org/history.htm>. As well, the American Association of Franchisees and Dealers developed voluntary standards for fair franchising, which would enable franchisors that met the standards to display a "Fair Franchising Seal": see The American Association of Franchisees and Dealers, *Fair Franchising Standards* (revised August 2002), online: <http://aafd.org/images/logo/Standards.pdf>.

[232] U.S. General Accounting Office, *supra* note 226 at 70-71, outlining the views of the American Franchisee Association.

[233] See U.S. General Accounting Office, *supra* note 226 at 72-74, summarizing the views of the U.S. International Franchise Association, which opposed federal franchise relationship legislation. The IFA also opposed proposed "minimum standards of fair conduct", which included a duty of good faith, a duty of due care (or competency) and a fiduciary duty for franchisors in relation to accounting and advertising programs. Note, however, that the plaintiff in *Halligan v. Liberty Tax Service Inc*., 2003 MBQB 174, 36 B.L.R. (3d) 75; supplementary judgment 2006 MBQB 75, [2006] 8 W.W.R. 97 (discussed in chapter 2) advised the Commission that his relationship with the franchisor had been productive and fruitful, with problems addressed in a mutually beneficial manner, until a change of ownership of the franchisor occurred: submission by T. Halligan (February 4, 2008). Careful pre-sale investigation and assessment of the problems likely to occur in a franchise relationship may not be sufficient where the ownership of the franchisor is subsequently transferred.

[234] There is also no private right of action for franchisees under the U.S. FTC Franchise Disclosure Rule, and the American Franchisee Association has advocated for franchisee access to the courts: see Janean Chun, "Separate but equal? Two associations seek franchise reform through different means – American Franchisee Association, AFA, and the American Association of Franchisees & Dealers - AAFD" *Entrepreneur* (September 1996), online: <http://findarticles.com/p/articles/mi_m0DTI/is_n9_v24/ai_18648850>.

been suggested that existing Canadian legislation already goes too far and that Canada should have adopted the UNIDROIT "less is more" approach to franchise regulation:

> Because of the strong presence of lawyers with extensive experience on behalf of franchisors operating internationally, the frequent and well-intentioned efforts to inject more and more protections on behalf of the franchisee were tempered by the larger consideration that in the final analysis legislators could end up protecting the franchisees right out of a livelihood by introducing overly burdensome laws. Even worse, legislation might protect the economy right out of the jobs and wealth that franchising produces. Although the debate among franchisor and franchisee counsel and lobbyists continues about the legitimacy of the claim, Alberta's 1971 act and Iowa's present relationship law are cited as examples of the macroeconomic harm that overburdensome regulation produces. In business, fear – no matter how irrational – is a deterrent.[235]

One specific suggestion made to the Commission that was raised in the consultation paper relates to the sale of a franchise by a franchisee. Frequently, if a franchisee sells his or her franchise and assigns the agreement and/or sub-lease to the purchaser, the original franchisee remains liable for all obligations contained in the agreements. This is a typical provision of commercial leases. However, some franchise agreements also provide that if the purchaser subsequently renews the agreements for a further term, the original franchisee continues to be liable for all obligations of the purchaser under the renewed agreements, despite having had no input into their terms. It was suggested that Manitoba franchise legislation provide that, in this situation, the obligations of the franchisee do not extend beyond the term of his or her original agreements and any renewals signed by that franchisee.[236]

Respondents to the consultation paper again presented differing views on franchise relationship regulation. As noted earlier, there was strong support for uniformity among the Canadian jurisdictions; some respondents also more specifically expressed that Manitoba legislation should not deviate from the limited general relationship standards in the existing Canadian model.[237] As one experienced franchise law practitioner explained:

> I have seen the benefits that franchising can bring and the difficulties that are encountered in the franchise relationship. I have certainly witnessed abuses by franchisors, but I have also experienced franchisees who created incredible difficulties for the franchisor and all of the other franchisees in a given system. I have thought about and considered, many times, the imposition of more intrusive franchise legislation than presently exists in Canada. However, without the benefit of reliable statistical information, I cannot support that type of legislation and believe that the franchise legislation of the type in Alberta, Ontario, and PEI is appropriate for the Canadian franchise marketplace.[238]

Another submission expressed similar views:

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[235] Dillon, "Will Franchising Survive?", *supra* note 137: the author served as the Canadian consultant on the UNIDROIT project (n. 5).

[236] Correspondence from A.L. Weinberg, Q.C. (January 2, 2007).

[237] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007).

[238] Submission by E. Levitt (July 19, 2007) at 1.

> We strongly resist and oppose franchise laws in Canada which will be invasive with respect to specific contractual requirements. We do not believe that provincial franchise laws should address contractual matters such as termination, renewal or transfer, encroachment, purchase requirements and the like. To do so would not only result in a lack of uniformity in franchise legislation across the country, but would also result in discriminatory favouritism for franchisees in one province versus those in other provinces. In addition, such requirements generally include "good cause" definitions which often become uncertain in their application and result in litigation.[239]

Similarly, the Canadian Franchise Association supported "franchise disclosure legislation without specific relationship standards or mandatory contractual requirements".[240]

One submission commented on the suggestion noted above, in relation to the liability of an original franchisee under a lease that is assigned and subsequently renewed:

> [T]he continuing liability of an original franchisee to a franchise agreement should be a matter of contract and negotiation, and not legislated. In certain cases it may well be an economic reality that the original franchisee must remain liable for the obligations of a successor but under-capitalized or inexperienced franchisee. It may also be possible in such a case that there is only a very small period of time remaining in the initial term.[241]

The Commission also received submissions in support of regulating additional aspects of the franchise relationship. For example, one submission recommended that Manitoba legislation prohibit the termination of or failure to renew a franchise agreement except for cause, require all franchisees to be treated equally within a franchise territory and provide that a franchisor's approval for the sale or transfer of a franchise may only be withheld on reasonable grounds. Where a franchise is terminated, there should be some provision for the franchisor to assist with the burden of employee costs arising under employment standards legislation.[242]

Another submission recommended that Manitoba legislation:

- prohibit franchisors from competing directly with franchisees through corporate units or the internet;
- restrict franchisors' ability to encroach on existing franchisees' territories;
- provide that a franchisee has the first right of refusal on the purchase of bordering territories;
- prohibit franchisors from holding the lease on franchised premises;
- require full disclosure of previous legal disputes with franchisees;

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[239] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 8.

[240] Submission by the Canadian Franchise Association (July 30, 2007) at 2: the CFA expressed support for a statutory duty of fair dealing.

[241] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 8.

[242] Submission by the Manitoba Motor Dealers Association (July 27, 2007). See also *The Farm Machinery and Equipment Act*, *supra* note 222, s. 16.4, which prohibits farm machinery and equipment vendors from discriminating in the prices charged to, or imposing substantially different contractual requirements on, similarly situated dealers.

- provide that franchisees are authorized to purchase goods from suppliers not specified by the franchisor when quality and pricing dictate;
- provide that when the terms of a franchise agreement are changed on renewal by the franchisor and an agreement cannot be reached as to the terms, the franchisor should be required to buy back the franchise at the original purchase price or release the franchisee from the agreement; and
- set penalties for the failure by franchisors to comply with the terms of the franchise agreement.[243]

A further submission recommended provisions respecting the termination, renewal and sale of a franchise agreement, to:

- prohibit a franchisor from terminating a franchise agreement except for good cause; "good cause" should include the failure of a franchisee to comply with any material lawful requirement of the agreement, provided that the termination is not arbitrary or capricious when compared to the actions of the franchisor in other similar circumstances (the Iowa Act model);
- allow a franchisee the opportunity to cure an alleged default after receiving written notice, within a 30 day period or a longer term agreed by the parties;
- exempt certain terminations from the opportunity to cure, such as terminations relating to the bankruptcy of the franchisee or the franchised business;
- provide for the payment of liquidated damages by a franchisee who fails to cure a default;
- require a franchisor who wishes to terminate a franchise agreement with a franchisee who is not in default to pay a pro-rated value of the franchise as assessed by an independent business advisor;
- prohibit a franchisor from failing to renew a franchise agreement without six months' notice and good cause - where the franchisor is withdrawing completely from a geographic market the franchisor should be required to compensate the franchisee and be prohibited from enforcing any non-competition covenant and from re-entering the market area for a reasonable time;
- allow a franchisee to renew a franchise agreement at a different location within a specified distance from the original location;
- in relation to the liability of an original franchisee under a lease that is assigned and subsequently renewed, provide that a franchisor may only reject a purchaser of a franchise with good cause, that a franchisor must provide a disclosure document and training upon transfer and that a provision in a contract that attaches liability to a former franchisee is void.[244]

Another respondent suggested franchise relationship provisions to:

- in relation to the liability of an original franchisee under a lease that is assigned and subsequently renewed, prohibit the extension of the original franchisee's liability beyond

[243] Submission by A. Donald (August 19, 2007).

[244] Submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007).

the initial term of the franchise agreement where the original franchisee is not a party to the renewed agreement;

- in the case of a bankruptcy or insolvency of a franchisor, provide that a franchisee has the right to terminate the franchise agreement after 60 or 120 days of receipt of notice and that any non-competition covenants are void;
- ensure that a franchisee has the right to purchase products from alternative suppliers to those designated by the franchisor, provided the franchisee can provide reasonable evidence that the products are of the same quality;
- provide that where a franchisor does not approve alternate suppliers whose products are of the same quality, the franchisor must pay the franchisee's costs incurred in establishing that the products are of the same quality, including legal fees on a solicitor-client basis;
- in the event of a corporate franchisee, prohibit the franchisor from requiring more than one personal guarantor or covenantor and in the case of an individual franchisee prohibit additional personal covenants.[245]

The Commission recognizes that there are strong arguments, and strongly held views, on both sides of this issue. The duty of both parties to a franchise agreement to act in good faith and in accordance with reasonable commercial standards means that a party cannot disregard the interests of the other party. This duty would provide a right of action for franchisees for some forms of harmful franchisor conduct. On the other hand, a party may act in its own interests so long as it deals promptly, honestly, fairly and reasonably with the other party.[246] And while the parties to a franchise agreement are in theory free to negotiate a contract that reflects their wishes, franchise agreements are most often contracts of adhesion and franchisees in fact have little input as to their terms. The parties are not subject to the duty of fair dealing when negotiating a franchise agreement and courts will not imply many contractual terms that are not expressly included. Careful pre-sale investigation and assessment of the problems likely to occur in a franchise relationship may not be sufficient where the ownership of the franchisor is subsequently transferred. In the Commission's view, the imbalance of power between the parties during negotiations and inherent in the franchise relationship requires that some conduct obligations be specified in legislation.[247] Where appropriate, the parties to a franchise agreement should be subject to reciprocal obligations.

After careful consideration, the Commission considers that certain relationship provisions are warranted in Manitoba franchise legislation.

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[245] Submission by A.L. Weinberg (July 18, 2007).

[246] *Shelanu, supra* note 97.

[247] The Commission is not persuaded that this will result in an unacceptable level of uncertainty within the franchise environment; concepts such as "fair dealing", "fundamental breach" and "unconscionable conduct" are regularly encountered by franchisors and franchisees and interpreted by the courts. Note that Manitoba's *Farm Machinery and Equipment Act* sets out circumstances that are cause for termination of a dealership agreement under the Act, as well as circumstance that are not cause for termination: *The Farm Machinery and Equipment Act, supra* note 222, s. 16.6-16.7.

RECOMMENDATION 52

The Act should include provisions to:

- ***prohibit a party to a franchise agreement from terminating the franchise agreement without just cause and provide a right of action for damages for a contravention of this provision;***
- ***require a party to a franchise agreement to allow the other party a reasonable time to remedy a breach of the franchise agreement after receiving written notice – exceptions should be provided for breaches that are not curable, such as bankruptcy or abandonment of the franchised premises;***
- ***where a franchise agreement does not include an option to renew, prohibit a franchisor from failing to renew the agreement without just cause – where the franchisor is withdrawing from a geographic market the franchisor should be required to compensate the franchisee and a non-competition covenant should be unenforceable;***
- ***provide that the fact that a franchise agreement authorizes a franchisor to unilaterally vary a term or condition of the agreement is a factor that a court may consider when determining whether the franchisor has complied with the duty of fair dealing;***
- ***provide that where the terms of a franchise agreement are materially changed by the franchisor on renewal and agreement cannot be reached as to the terms, the franchisor must buy back the franchise at the original purchase price or release the franchisee from the franchise agreement;***
- ***provide that a franchisor's approval for the sale or transfer of a franchise may only be withheld on reasonable grounds and that a franchisor may not require, as a condition of the transfer, that the franchisee undertake obligations or relinquish rights unrelated to the franchise being transferred or enter into a release of claims that is broader than a release entered into by the franchisor;***
- ***provide that where a franchise is sold or transferred, the liability of the original franchisee does not extend beyond the terms of that franchisee's agreement;***
- ***provide that a franchisee may purchase goods or services from sources other than those designated by the franchisor where the goods or services are of comparable quality – exceptions should be provided for goods or services that are central to the franchised business and are manufactured or produced by the franchisor or franchisor's associate or that incorporate a trade secret owned by the franchisor or franchisor's associate; and***
- ***provide that where a franchise agreement provides for an exclusive territory, a franchisee has a cause of action for damages if a franchisor allows encroachment, including competition by corporate units and internet and direct sales methods, that adversely affects the franchisee's sales.***

P. ALTERNATIVE DISPUTE RESOLUTION

The use of alternative dispute resolution mechanisms is growing in popularity in the franchise industry; in part, it is said, because of the legislated requirements for franchisors to disclose to franchisees the existence of concluded or pending litigation (but not disputes addressed through alternative dispute resolution). Some franchisors have inserted mandatory binding arbitration or other alternative dispute resolution provisions in their franchise agreements.[248] Alternatively, franchisors and franchisees may agree to voluntary mediation or other alternative dispute resolution processes.

Alternative dispute resolution methods may have benefits over litigation, in that they may be cheaper, more private and less combative than court processes. ADR is often considered to be particularly appropriate in the context of ongoing business relationships, and may enable the business relationship to be preserved.[249] In 1994, the Manitoba Law Reform Commission issued the *Arbitration Report*,[250] in which we noted the advantages of alternative dispute resolution methods, including voluntary binding arbitration.

In relation to franchises, the Ontario Franchise Sector Working Team recommended that alternative dispute resolution methods be explored and adopted,[251] and the concept was raised at the public hearings on the Ontario Act. On the other hand, the American Franchisee Association has noted that *mandatory* arbitration provisions in franchise agreements can be a disadvantage to franchisees, in that arbitration is private and does not result in useful precedents,[252] so that other franchisees do not benefit from a decision. As well, in the most flagrant fact situations, a contract providing for mandatory arbitration may prohibit any award of punitive damages that might otherwise be available.

In the U.S., a national franchising mediation program was developed in 1993 by a steering committee of franchisor companies who were growing increasingly concerned about media reports of unfair treatment of franchisees by some franchisors.[253] The program operates through the Center for Public Resources Institute for Dispute Resolution[254] and is non-binding and voluntary, although franchisors are asked to join for a minimum two year period.

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[248] Daniel F. So, *Canadian Franchise Law Handbook* (Markham, Ont.: LexisNexis Butterworths, 2005) at 266.

[249] *Ibid.* at 264.

[250] Manitoba Law Reform Commission, *Arbitration* (Report #85, 1994).

[251] Ontario Franchise Sector Working Team, *Franchise Sector Working Team Report* (August 30, 1995) in Frank Zaid, *Canadian Franchise Guide*, looseleaf (Toronto: Carswell, 1993) at 2 - 142J-142Z.4.

[252] American Franchisee Association, *The Twelve Worst Franchise Agreement Provisions*, online: <http://www.franchisee.org/Buying%20a%20Franchise.htm>.

[253] Morton Aronson, "National Franchise Mediation Program: Where Do We Go From Here?" 29:3 *Franchising World* (May/June 1997); F. Peter Phillips, "The National Franchise Mediation Program: A Business-like Alternative to Suing Your Business Partner" 33:1 *Franchising World* (Jan/Feb 2001).

[254] See the Center for Public Resources website at <http://www.cpradr.org/CMS_disp.asp?page=frn_whatis&M=7.12>. The CPR reports a success rate of approximately 80% in cases in which the franchisee agreed to participate, and in which a mediator was needed. Additional disputes were resolved before requiring a mediator.

The Canadian Franchise Association offers a free, confidential Ombudsman service to members of the Association. The service is described as "a neutral, independent resource who provides informal, confidential assistance to help with the resolution of concerns & complaints".[255] The Ombudsman facilitates possible solutions, and refers unresolved complaints, where appropriate, to alternative methods of dispute resolution.[256] As well, the Arbitration and Mediation Institute of Manitoba promotes the use of appropriate dispute resolution processes and provides a free referral service for those requiring the services of a dispute resolution practitioner.[257] The Institute is the regional affiliate of the ADR Institute of Canada, a non-profit organization that has developed and promulgated nationally a set of rules for arbitration and mediation to provide for an inexpensive method of having an arbitrator or mediator appointed for a dispute.[258] The rules include a model clause that parties who agree to mediate or arbitrate under the rules in the event of a dispute may include in their agreement.

The Ontario and P.E.I. regulations require a franchisor to describe any alternative dispute process used or imposed by the franchisor; the P.E.I. regulations also require the location or venue of the process to be disclosed. In Ontario, the disclosure document must include a statement that any party may propose an alternative dispute resolution process, which may be used if agreed to by all parties.

The ULCC Model Bill and the New Brunswick Act set out a mediation process. One party to a franchise agreement may deliver a notice to the other party setting out the nature of the dispute and the desired outcome; the parties must then attempt to resolve the dispute within 15 days after delivery of the notice. If the parties fail to resolve the dispute within 30 days of delivery of the notice, a party may deliver a notice to mediate to all parties to the franchise agreement. The parties must then follow the rules set out in the regulations.

The ULCC regulations contemplate mediation being initiated either before or after the commencement of litigation. The New Brunswick Act also specifically provides that the mediation process does not preclude a party from taking any other measure in relation to the subject matter of the dispute. This provision is not in the Model Bill.

According to the ULCC Working Group,

> [t]he Committee considered at great length whether franchise disputes would be resolved more advantageously through a form of alternative dispute resolution. Recognizing that in certain provinces the rules of practice in civil proceedings mandate a form of pre-trial mediation, and recognizing that the Ontario Act contains a mandatory disclosure statement that mediation is a form of dispute resolution, the Committee

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[255] Canadian Franchise Association, *Franchise Ombudsman Program*, online: <http://www.cfa.ca/page.aspx?url=OmbudmansProgram.html>.

[256] *Ibid.*

[257] See the Arbitration and Mediation Institute website at <http://www.amim.mb.ca>.

[258] Email correspondence from Barry Effler, past President, ADR Institute of Canada (February 6, 2008): the National Mediation Rules and the National Arbitration Rules are available on the ADR Institute of Canada website: http://www.adrcanada.ca/rules.html.

> determined that it would be beneficial to provide for mediation to be invoked by any party to a franchise agreement.
>
> The Committee believes based on its own experiences and those brought to the attention of the Committee that party initiated mediation will be of significant benefit to resolve franchise disputes prior to the commencement of, as well as after the commencement of, litigation proceedings.[259]

The Commission received submissions in response to the consultation paper in support of the ULCC mediation model:

> We note that the New Brunswick legislation adopts the ULCC Act model of allowing self-initiated voluntary mandatory mediation. We believe that this procedure will prove to be very beneficial as many franchise disputes are resolved at the mediation stage. A streamlined mediation process, as outlined in the ULCC Act, is one which we believe will be of benefit to both parties and will reduce additional pressure on provincial courts to resolve disputes. We do not believe that mandatory mediation or arbitration is necessary or useful, and our experience to date is that arbitration of franchise disputes has not shown itself to be less expensive, more efficient or more remedial in nature than the judicial process.[260]

Another respondent described the development of pre- and post- litigation party initiated mandatory mediation in the ULCC Bill as a "key innovative feature":

> As jurisdictions continue to address civil justice reform initiatives to address the need for access to justice the dispute resolution mechanism contained in the Uniform Act serves a vital need of providing for access to effective dispute resolution for both the franchisor and the franchisee. However due to the prevalence of the power imbalance between the franchisor and franchisee the ability to access dispute resolution is particularly important for the franchisee.[261]

A respondent experienced in conducting franchise mediations commented that

> [m]any disputes settle at mediation. One important reason is that the mediation event itself becomes a target for settlement discussions. When a date is set aside and mediator retained, the parties prepare for and attend the mediation with a concentrated focus on exploring settlement options. Holding the event itself is a catalyst towards settlement …
>
> The mediation also provides a good environment in which to discuss problems and to address misinformation that often fuels disputes between franchisors and franchisees …
>
> Consider whether there should be cost consequences in the event that a party fails to attend a mandatory mediation. The regulation could contain a statement encouraging each

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[259] ULCC, *Uniform Franchises Act Working Group Commentary*, *supra* note 23 at 22.

[260] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 9.

[261] Submission by B. Macallum (August 20, 2007) at 1.

> party to obtain independent legal and financial advice in relation to any settlement before settling a dispute, and encouraging each party to have legal counsel at the mediation.[262]

The Commission also received a submission in support of mandatory arbitration for disputes that are primarily question of fact:

> The Consultation Paper contemplates mandatory mediation. If mediation is not successful, I suggest that the Commission consider mandatory arbitration for specific disputes between franchisors and franchisees based on specific breaches of disclosure and/or performance requirements which are primarily questions of fact rather than questions of mixed fact and law or questions of law. For example, most franchise agreements provide that the franchisor will provide the franchisee with a training program. In many cases, the franchisor fails to provide the training program and the franchisee finds itself trying to operate a business about which the franchisee knows very little. The franchisee purchased the franchise based in part on the undertaking of the franchisor to train the franchisee. If this training is not provided, the likelihood of the franchisee failing is significantly increased. The question as to whether or not the training program was provided is a question of fact which could be determined by binding arbitration.[263]

Not all respondents supported mandatory alternative dispute resolution, however. Some respondents recommended caution:

> I am generally very much in favour of dispute resolution mechanisms other than court proceedings. I also feel that the Uniform Law Commission approach was useful, in that it provided for the implementation of an alternative dispute resolution process where the province did not have, as is the case in Ontario, a court annexed mediation process. Having said that, it is my experience that alternative dispute resolution works best, whether mediation, arbitration or otherwise, when the parties agree to it voluntarily and establish the parameters for the process after the dispute has arisen. It is very difficult to know in advance what mechanism will be appropriate for a particular set of circumstances.[264]

Similarly, another respondent expressed concern:

> Our concern with mandatory mediation is its effect on the contractual rights of the parties, especially with respect to termination rights triggered by a serious breach of the franchise agreement. For example, if a Tim Hortons franchisee abandons or attempts to abandon the premises, then Tim Hortons is entitled to terminate the License Agreement and take possession of the store immediately. If the UFA mediation section is used in Manitoba, then Tim Hortons' ability to terminate defaulting franchisees may be compromised, which would significantly prejudice the franchisor's enforcement of its legitimate rights.[265]

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[262] Submission by J. Flanders (August 20, 2007) at 1.

[263] Submission by A.L. Weinberg (July 18, 2007) at 3.

[264] Submission by E. Levitt (July 19, 2007) at 3.

[265] Submission by the TDL Group Corp. (Tim Hortons) (July 31, 2007) at 2.

One respondent suggested that "a separate means for resolving disputes could be provided through a mediation panel consisting of franchise professionals".[266]

Finally, the Commission received a submission arguing against including provisions for either mandatory mediation or mandatory arbitration. The respondents noted that mediation is less adversarial than arbitration, and less disruptive of business relationships. As well, entering into a mediation process is essentially without risk since other options are available if mediation is unsuccessful. However,

> [m]ediation will fail if the parties are not willing to partake in the process and resolve the dispute. Consequently, forcing parties to mediate through a mandatory mediation program may very well be a waste of time and money in such instances.[267]

Further, "a dispute resolved through arbitration can be as costly in terms of fees and costs as a case going before a court. Furthermore, if one of the parties is litigious in nature or is drawn to arbitration against its will, arbitration can also be a slow process which may take months and, sometimes, years before a final decision is reached and enforced".[268] The submission recommended, however, that thorough disclosure of possible alternative dispute resolution processes be required, including the methods for selecting a mediator or arbitrator, governing rules, costs, governing law, venue and confidentiality.

As noted, the Commission supports and encourages the use of alternative dispute resolution mechanisms. We agree with the observations of the ULCC Working Group that mediation processes can be of significant benefit in the resolution of franchise disputes. Although the Manitoba Court of Queen's Bench Rules do not mandate pre-trial mediation, in the experience of the Commission the court actively promotes mediation, and mediation is a common pre-trial practice. However, the Commission is inclined to agree with the points raised against the inclusion of mandatory alternative dispute resolution provisions in franchise legislation. In the Commission's experience, alternative dispute resolution methods can be remarkably successful, but this success is dependent on the parties' voluntary participation. The Commission does not consider that mandatory alternative dispute resolution provisions are appropriate in franchise legislation at this time. The Commission does support the inclusion of a provision similar to subsection 5(2) of the Ontario regulation, which requires every disclosure document to include a statement advising that mediation is a voluntary process to resolve disputes with the assistance of a third party, any party may propose mediation and the process may be used if agreed to by all parties.

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[266] Submission by the Canadian Federation of Independent Grocers (August, 2007) at 3.

[267] Submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007) at 50.

[268] *Ibid*.

RECOMMENDATION 53

The regulations should require that a disclosure document include a statement that advises that mediation is a voluntary process to resolve disputes with the assistance of a third party, any party may propose mediation and the process may be used if agreed to by all parties.

The Commission agrees that where a franchise agreement includes provisions that require mediation or arbitration, thorough disclosure of all elements of the process should be required, including the methods and criteria for selecting a mediator or arbitrator, governing rules and procedures, costs, location or venue and confidentiality.

RECOMMENDATION 54

The regulations should provide that where a franchise agreement contains provisions for arbitration or mediation, thorough disclosure of all elements of the process must be provided, including the methods and criteria for selecting a mediator or arbitrator, governing rules and procedures, costs, location or venue and confidentiality.

Q. CLASS PROCEEDINGS

As we have discussed, a franchise agreement may contain provisions requiring that any disputes that arise between the franchisor and franchisee must be resolved by arbitration. Such provisions generally prohibit the franchisee from commencing an action in court, individually or by class action, in relation to any dispute. While the Commission supports the use of alternative dispute resolution mechanisms, the use of mandatory arbitration provisions and their effect on the availability of class proceedings for franchisees requires further consideration.

The Commission has examined issues surrounding class proceedings in a previous report. In our 1999 report, *Class Proceedings*,[269] the Commission identified three rationales that are usually given in support of the expansion of class proceedings: improved access to justice for plaintiffs, more efficient use of judicial resources and the provision of a mechanism for accountability. The Supreme Court of Canada subsequently elaborated on these rationales in *Western Canadian Shopping Centres Inc. v. Dutton*,[270] as follows:

> Class actions offer three important advantages over a multiplicity of individual suits. First, by aggregating similar individual actions, class actions serve judicial economy by avoiding unnecessary duplication in fact-finding and legal analysis. The efficiencies thus generated free judicial resources that can be directed at resolving other conflicts,

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[269] Manitoba Law Reform Commission, *Class Proceedings* (Report #100, 1999).

[270] *Western Canadian Shopping Centres Inc. v. Dutton*, 2001 SCC 46, [2001] 2 S.C.R. 534.

> and can also reduce the costs of litigation both for plaintiffs (who can share litigation costs) and for defendants (who need litigate the disputed issue only once, rather than numerous times) …
>
> Second, by allowing fixed litigation costs to be divided over a large number of plaintiffs, class actions improve access to justice by making economical the prosecution of claims that would otherwise be too costly to prosecute individually. Without class actions, the doors of justice remain closed to some plaintiffs, however strong their legal claims. Sharing costs ensures that injuries are not left unremedied ...
>
> Third, class actions serve efficiency and justice by ensuring that actual and potential wrongdoers do not ignore their obligations to the public. Without class actions, those who cause widespread but individually minimal harm might not take into account the full costs of their conduct, because for any one plaintiff the expense of bringing suit would far exceed the likely recovery. Cost-sharing decreases the expense of pursuing legal recourse and accordingly deters potential defendants who might otherwise assume that minor wrongs would not result in litigation.[271]

In the Commission's report, we recommended a statutory class proceedings regime for Manitoba, noting "the need to provide a means of redress to people whose injuries are insufficient, except in the aggregate, to make pursuing compensation in the judicial system economically feasible … Class proceedings legislation will also hold wrongdoers accountable for wrongs that might not be pursued by individual victims, thereby enhancing the fairness of society as a whole".[272] *The Class Proceedings Act*[273] was subsequently enacted and came into force on January 1, 2003.

Arbitration and class proceedings schemes are each intended to increase access to justice and maximize the use of judicial resources. However, there can be tension between the two methods, particularly where the individual amounts in dispute are relatively small. Although arbitration may be a cheaper alternative to litigation, it is not necessarily low cost.[274] Where there are multiple claimants and small individual amounts, class proceedings may be a more efficient use of resources.

In Manitoba, as in other jurisdictions, neither an arbitration agreement nor the availability of class proceedings clearly takes precedence over the other. *The Arbitration Act* requires a court to stay a proceeding commenced in court, except in specific cases, if it deals with a dispute that is required to be submitted to arbitration under an arbitration agreement.[275] *The Class*

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[271] *Ibid*. at paras. 27-29; see also *Hollick v. Toronto (City)*, 2001 SCC 68, [2001] 3 S.C.R. 158

[272] Manitoba Law Reform Commission, *supra* note 269 at 35.

[273] C.C.S.M. c. C130.

[274] As one submission noted, "our experience to date is that arbitration of franchise disputes has not shown itself to be less expensive, more efficient or more remedial in nature than the judicial process": submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 9.

[275] C.C.S.M. c. A120, s. 7.

Proceedings Act requires a court to certify a proceeding as a class proceeding if certain criteria are satisfied, [276] and does not address the effect of arbitration agreements.

Circumstances involving the tension between these dispute resolution methods were recently addressed by the Supreme Court of Canada. The court ruled on the validity of mandatory arbitration provisions in relation to class proceedings in the context of consumer agreements, in *Dell Computer Corp. v. Union des consommateurs*[277] and *Rogers Wireless v. Muroff*.[278] In *Dell*, the defendant company mistakenly advertised sale prices for handheld computers on its website, and the class action plaintiffs sought to have the sale price honoured. In *Rogers*, the plaintiff brought a class action on behalf of himself and other subscribers challenging the validity of certain long distance roaming charges. In both cases, the key issue in dispute was the validity of mandatory arbitration clauses within the consumer contracts. The clauses provided that in the case of a dispute, a consumer must submit to binding arbitration and could not seek recourse in court, either individually or by class action. In both cases the Supreme Court held that the arbitration clauses were valid and the class actions could not proceed.

The *Dell* and *Rogers* cases have been criticized for jeopardizing consumer class actions in contractual cases:

> Certainly, class actions have their weaknesses, but the solution is to amend the legislation and not to privatize the dispute-settlement procedure at the defendant's option. On the whole, Canadian courts have handled class actions fairly and responsibly. …
>
> Of course, the object of an arbitration clause may be to avoid class claims altogether and to be able to pick off those plaintiffs, one at a time, that have the deep pockets and the perseverance to pursue individual claims. It is precisely this mischief that class action legislation was designed to reverse and that regrettably the members of the Supreme Court failed firmly to keep in mind in addressing the technical issues before them.[279]

Another commentator has noted:

> Businesses are increasingly inserting arbitration clauses into standard form contracts. In the event of a dispute, these clauses deny consumers access to the courts, including small claims courts and class proceedings. The costs of arbitrating may effectively deny consumers access to any forum at all.[280]

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[276] *Supra* note 273, s. 4.

[277] 2007 SCC 34, [2007] 2 S.C.R. 801 [*Dell*].

[278] 2007 SCC 35, 284 D.L.R. (4th) 675 [*Rogers*].

[279] Jacob Ziegel, "Canada's Top Court Has Sold Out Consumers By Handing Businesses An Easy Way To Avoid Class Action Suits" *Financial Post* (9 August 2007), online: <http://www.financialpost.com/story.html?id=81511 a9c-8c02-4f3b-a0c2-0651b10e3d96>.

[280] Jonnette Watson Hamilton, "Pre-Dispute Consumer Arbitration Clauses: Denying Access to Justice?" (2006) 51 McGill L.J. 693 at para. 1.

There have not been many franchisee class proceedings in Canada to date, but Ontario courts have had some experience. Recently, in *Al-Harazi v. Quizno's Canada Restaurant Corp.*,[281] the Ontario Superior Court of Justice certified a franchisee class proceeding and approved a proposed settlement in relation to approximately 170 Quizno's franchisees who had not obtained a restaurant site after paying a franchise fee of $25,000 each. The Ontario *Class Proceedings Act* requires, among other things, that "a class proceeding would be the preferable procedure for the resolution of the common issues".[282] On this point, the court said:

> I do not think there is any doubt that the fourth requirement … is also satisfied for the purpose of the settlement. Access to justice will be achieved by a class proceeding as individual proceedings would be prohibitively expensive for many, if not most, of the class members. Judicial economy and behavioural modification are also likely to be advanced.[283]

The equivalent provision of the Manitoba Act is similar to that of Ontario. Paragraph 4(d) of *The Class Proceedings Act* requires that "a class proceeding would be the preferable procedure for the fair and efficient resolution of the common issues".[284]

In another franchisee class action suit, the Ontario Superior Court of Justice granted an injunction against the franchisor to restrain its misconduct in response to the claim. Franchisees of the A&P supermarket chain had launched a class action with respect to product rebates. The franchise agreement provided for a system of distribution of product rebates received by the franchisor to franchisees, but A&P had ceased disclosing specific information about the rebates. The court certified the lawsuit as a class action,[285] and also found that A&P had engaged in a course of conduct designed to intimidate and coerce franchisees into releasing it from the lawsuit. A&P was prohibited from circulating new franchise agreements and releases and from communicating with franchisees about the action. The parties eventually settled the case.[286]

The effect of the *Dell* and *Rogers* decisions on the validity of mandatory arbitration clauses in franchise agreements with respect to franchisee class proceedings is not clear, and some commentators suggest that the impact of the decisions may be limited to Quebec.[287] In a post-*Dell* and *Rogers* case, the Ontario Superior Court of Justice recently considered the effect of a mandatory arbitration clause in a franchise agreement in an application for certification of a

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[281] [2007] O.J. No. 2819 (QL). The class members claimed the right to rescind the franchise agreements on the basis that the franchisor had not provided a disclosure document within the meaning of the Act and had failed to assist the prospective franchisees to find viable locations.

[282] *Class Proceedings Act, 1992*, S.O. 1992 c. 6, s. 5(1)(d).

[283] *Supra* note 281 at para. 35.

[284] *Supra* note 273, s. 4(d).

[285] *1176560 Ontario Ltd. v. Great Atlantic & Pacific Co. of Canada* (2002), 62 O.R. (3d) 535 (S.C.J.); aff'd (2004) 70 O.R. (3d) 182 (Div. Ct.).

[286] The action was settled in 2004. A&P paid compensation and acquired franchises of the plaintiffs for the sum of $41.5 million: Zaid, *Franchise Law*, *supra* note 25 at 351.

[287] See the discussion of the reaction to *Dell* and *Rogers* in Manitoba Law Reform Commission, *Mandatory Arbitration Clauses and Consumer Class Proceedings* (Report #115, 2008).

class action.[288] The defendants had moved for a stay of proceedings, partly on the basis that the plaintiffs had contracted out of a class proceeding through a mandatory arbitration clause in the franchise agreement. The court concluded that the plaintiffs failed to satisfy all of the elements of the test for certification, and that the action should not be certified as a class proceeding. The motion for a stay was therefore moot. However, for the purposes of a possible appeal, the court outlined the ruling that it would have made on the motion. Perell, J. adopted the approach of courts in British Columbia and Ontario, which held (pre-*Dell* and *Rogers*) that the existence of an agreement to arbitrate a dispute will be considered as a factor in determining whether a class proceeding is the preferable procedure,[289] and explained as follows:

> On the stay motion, on public policy grounds associated with the administration of justice, I reason that as a general principle, an agreement to contract out of class proceedings legislation should be read down so that it is just a strong factor in determining whether a class proceeding is the preferable procedure for the resolution of the common issues. This means that contracting out clauses are neither categorically enforceable nor categorically unenforceable and their enforcement will be determined in the context of a certification motion. (This is similar to the law about the effect of arbitration provisions.) Applying the general principle to the immediate case and based on the assumption (contrary to my conclusion) that a class proceeding was indeed the preferable procedure, it follows that a stay should not be granted.[290]

Ontario and Quebec amended their consumer protection statutes to invalidate mandatory arbitration clauses in consumer agreements while the *Dell* and *Rogers* cases were pending.[291] Both statutes provide that pre-dispute agreements that require arbitration are invalid. However, after a dispute has arisen, the parties may agree to arbitration. The Quebec Act provides that if a dispute arises after a contract has been entered into, the consumer may then agree to refer the dispute to arbitration. In Ontario, the parties may resolve a dispute by any procedure available in law after an action has been commenced.

The Ontario amendments provides as follows:

> 7.(1) The substantive and procedural rights given under this Act apply despite any agreement or waiver to the contrary.
>
> (2) Without limiting the generality of subsection (1), any term or acknowledgment in a consumer agreement or a related agreement that requires or has the effect of requiring that disputes arising out of the consumer agreement be submitted to arbitration is invalid insofar as it prevents a consumer from exercising a right to commence an action in the Superior Court of Justice given under this Act.

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[288] *2038724 Ontario Ltd. v. Quizno's Canada Restaurant Corp.* (2008), 89 O.R. (3d) 252 (S.C.J.).

[289] See *MacKinnon v. National Money Mart Co*., 2004 BCCA 473; *Smith v. National Money Mart Co*. (2005), 8 B.L.R. (4th) 159 (Ont. S.C.J.), aff'd (2005), 258 D.L.R. (4th) 453 (Ont. C.A.), leave to appeal refused [2005] S.C.C.A. No. 528.

[290] *Supra* note 288 at para. 12.

[291] *Consumer Protection Act, 2002*, S.O. 2002, c. 30, Sched. A; *Consumer Protection Act*, R.S.Q. c. P-40.1.

(3) Despite subsections (1) and (2), after a dispute over which a consumer may commence an action in the Superior Court of Justice arises, the consumer, the supplier and any other person involved in the dispute may agree to resolve the dispute using any procedure that is available in law.

(4) A settlement or decision that results from the procedure agreed to under subsection (3) is as binding on the parties as such a settlement or decision would be if it were reached in respect of a dispute concerning an agreement to which this Act does not apply.

(5) Subsection 7(1) of the *Arbitration Act, 1991* does not apply in respect of any proceeding to which subsection (2) applies unless, after the dispute arises, the consumer agrees to submit the dispute to arbitration.

8.(1) A consumer may commence a proceeding on behalf of members of a class under the *Class Proceedings Act, 1992* or may become a member of a class in such a proceeding in respect of a dispute arising out of a consumer agreement despite any term or acknowledgment in the consumer agreement or a related agreement that purports to prevent or has the effect of preventing the consumer from commencing or becoming a member of a class proceeding.

(2) After a dispute that may result in a class proceeding arises, the consumer, the supplier and any other person involved in it may agree to resolve the dispute using any procedure that is available in law.

(3) A settlement or decision that results from the procedure agreed to under subsection (2) is as binding on the parties as such a settlement or decision would be if it were reached in respect of a dispute concerning an agreement to which this Act does not apply.

(4) Subsection 7(1) of the *Arbitration Act, 1991* does not apply in respect of any proceeding to which subsection (1) applies unless, after the dispute arises, the consumer agrees to submit the dispute to arbitration.[292]

The Commission recognizes the advantages of arbitration in the commercial context, and while there are criticisms of the use of mandatory arbitration in franchising, we do not suggest that mandatory arbitration provisions in franchise agreements be prohibited. However, in the Commission's opinion, the principles supporting the availability of class action proceedings for consumers are persuasive in the franchise context. Prospective franchisees are not consumers, and as Ziegel notes, there is a "fundamental difference between the redress of consumer and business grievances".[293] However, unlike most business contracts, franchise agreements are generally contracts of adhesion, and franchisees rarely have an opportunity to influence the terms of the agreement or to choose freely whether to settle any disputes that arise by arbitration. To that extent, franchise agreements clearly have similarities to consumer contracts.

Mandatory arbitration clauses are becoming more common, and effectively deny access to justice for franchisees whose claims do not justify the cost, time or effort of arbitration on an individual basis, even though the aggregate of the franchisee claims may be sizeable. For

[292] *Consumer Protection Act, 2002, ibid.*

[293] Ziegel, *supra* note 279.

example, it is not likely that all of the 170 franchisees in *Al-Harazi* would have had the economic resources or incentive to pursue their claims individually in arbitration, given the amounts at stake. Collectively, however, the amount claimed was substantial. Multiple separate arbitrations would also not represent an efficient use of resources. Finally, separate arbitration proceedings may not provide sufficient incentive for franchisors who engage in persistent misconduct to change their behaviour, particularly where the misconduct affects a large number of franchisees but represents relatively small amounts of money on an individual basis.

In our recent report, *Mandatory Arbitration Clauses and Consumer Class Proceedings*,[294] the Commission considered the need for law reform in relation to mandatory arbitration clauses in consumer contracts. The report examines the issues surrounding mandatory arbitration in relation to consumer class proceedings in more detail. For the purposes of this report, the Commission is persuaded that franchise legislation should provide certainty with respect to this issue and that the availability of class proceedings should be protected. In the Commission's opinion, franchise legislation in Manitoba should provide that a mandatory arbitration clause in a franchise agreement is invalid insofar as it prevents a franchisee from participating in a class proceeding, and that a franchisee may commence or become a member of a class proceeding in respect of a franchise dispute notwithstanding any provision in a prior agreement that purports to preclude class proceedings.[295]

RECOMMENDATION 55

The Act should provide that:

- ***a provision in a franchise agreement that requires that disputes between the parties be submitted to arbitration is invalid insofar as it prevents a franchisee from commencing or becoming a member of a class proceeding;***
- ***a franchisee may commence or become a member of a class proceeding in respect of a dispute between parties to a franchise agreement despite any provision in a prior agreement that purports to preclude class proceedings.***

R. FRANCHISE REGULATORY BODY

In Ontario, it has been suggested that new legislation is needed to create a franchising regulatory body. The regulator's functions might include reviewing the quality of disclosure given to franchisees. The concept could also require some franchisors to post a bond, so that

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[294] Manitoba Law Reform Commission, *Mandatory Arbitration Clauses and Consumer Class Proceedings*, *supra* note 287.

[295] The action would still need to meet the requirements of *The Class Proceedings Act*, *supra* note 273, for certification as a class action: see *909787 Ontario Ltd. v. Bulk Barn Foods Ltd*. (2000), 138 O.A.C. 180 (Div. Ct.), allowing an appeal from a decision certifying a franchisee class action alleging overcharging by the franchisor in the supply of products to franchisees. As well, once a dispute has arisen, a franchisee would be able to waive the right to participate in a class proceeding in the context of a post-dispute settlement agreement.

franchisees who suffer damage will be compensated.[296]

It is argued that the existing Canadian legislation does not provide adequate protection for franchisees:

> Some franchisors are not giving adequate disclosure, and franchisees who have already invested a life's savings at the age of 40 or 50 are having to spend $50,000 to $100,000 to enforce their rights under franchise law to rescind their contracts and recover payments …
>
> "When a franchisee files a notice of rescission, the franchisor says: 'Sue me' … If the franchisor is bad enough not to give you a disclosure document to begin with, most likely he will not refund the money … People should not be forced to locate a franchise lawyer and litigate this, but should have the benefit of a regulatory body, given that franchising plays such an important role in our economy and more and more people are choosing to buy a franchise instead of set up their own business".[297]

The concept of a governing body with the power to impose substantial penalties, including cease trade orders, was supported by franchisee representatives on the Franchise Sector Working Team that made recommendations for franchise legislation in Ontario in 1995.[298]

Others have objected to this suggestion, arguing that it would add an unnecessary layer of administration that would "dissuade honest franchisors from conducting business [in Ontario] and increase the cost of doing business for franchisors and franchisees, thereby hurting us all".[299] The Canadian Franchise Association does not support the proposal, noting that it used to be a function of Alberta's securities commission to review franchise disclosure documents, but the scheme was repealed.[300]

A regulatory office could be structured in a number of ways. In the U.S. for example, the Federal Trade Commission conducts investigations of violations of the FTC Franchise Rule, and may seek a variety of remedies to enforce the Rule, including injunctions, monetary penalties and orders for refunds to franchisees. The FTC may initiate an investigation as a result of a complaint or on its own initiative (for example, following media reports).[301] Unlike the scheme established by the early franchise legislation in Alberta, however, franchisors are not required to register with the FTC and the FTC does not review or approve initial disclosure documents.

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[296] James Daw, "Government regulator could help both sides in a franchise: Province awaiting report from committee" *Toronto Star* (March 16, 2006).

[297] *Ibid.*, quoting Ben Hanuka, Chair, Ontario Bar Association Joint Subcommittee on Franchising.

[298] Ontario Franchise Sector Working Team, in Zaid, *Canadian Franchise Guide*, *supra* note 251.

[299] Daw, *supra* note 296, quoting lawyer Joseph Adler.

[300] *Ibid.*, referring to comments by Richard Cunningham, President of the Canadian Franchise Association (at that time). The Canadian Franchise Association explained further in its submission to the Commission that it does not support government review, approval, discretionary exemptions, registration of disclosure documents or intervention in franchise relations, disputes or rule-making: submission by the Canadian Franchise Association (July 30, 2007).

[301] U.S. General Accounting Office, *supra* note 226 at 46-54; however, due to limited resources, the FTC focuses on complaints that exhibit a pattern or practice of violations nationwide.

Similarly, in Australia, the Australian Competition and Consumer Commission investigates and brings proceedings against franchisors suspected of breaching the Code of Conduct. The Commission can also apply for injunctions and for compensatory orders on behalf of individuals who have suffered loss as a consequence of another person's breach.[302] Again, franchisors are not required to register with the ACCC.[303]

The Commission did not receive any submissions supporting the establishment of a regulatory body. For some respondents, the concept did bring to mind the registration scheme that existed under the first Alberta Act:

> We had considerable experience working with the Alberta Securities Commission up to and through the mid 1990's when the legislation of that province was regulated by the Alberta government. We had opportunity to witness inconsistent application of the legislation, discretionary practices without warning, regulatory delays, and significant professional fees for compliance.
>
> Franchise disclosure legislation as it currently exists in Canada does not require the presence of a provincial regulatory body. In fact, without the constitutional authority for a national regulatory body to be involved in franchising, provincial regulatory bodies may ultimately rule-make in an inconsistent manner or in a self-protectionist manner for the benefit of franchisees located in their jurisdictions, thereby leading to increased costs for franchisors and inconsistent policies from province to province.
>
> The franchise relationship is a business-to-business relationship, and not a business-to-consumer relationship, as some have attempted to define the relationship. On a business-to-business basis, prospective franchisees have the opportunity to obtain independent advice, have the benefit of franchise disclosure, and are entitled to certain rights and remedies for improper or non-disclosure under the legislation. There is no need for a government regulatory body to exist to oversee or over-regulate the relationship.[304]

Others echoed the Alberta experience:

> In 1995, the Province of Alberta rescinded its franchise registration legislation, as it was deemed to be overly cumbersome, slow and expensive for franchisors. While I can see some of the advantages of having a franchise regulatory body, again, until it can be demonstrated that there would be a significant enough benefit to the franchise marketplace, I would recommend that Manitoba not create such a body … [T]he trend in

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[302] Franchising Code Review Committee, *supra* note 213 at 26-27. See also John Martin, Commissioner, Australian Competition and Consumer Commission, *The Health of Franchising from the Viewpoint of its Regulator* (Paper for the Franchise Council of Australia Adelaide Conference, October 23, 2001), online: <http://www.accc.gov.au/content/index.phtml/itemId/179406>.

[303] While franchisor registration was recently recommended by the Franchising Code Review Committee, the Australian Government declined to implement this recommendation: Austl., Commonwealth, *Australian Government Response to the Review of the Disclosure Provisions of the Franchising Code of Conduct* (February 2007) at 8, online: <www.innovation.gov.au/Section/SmallBusiness/Documents/Response_to_Recommendations_(Final)06Feb0720070206091019.pdf>.

[304] Submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007) at 8-9.

> franchise regulation in Canada thus far is the best approach to protect the interests of prospective franchisees, without overburdening franchisors or governments. Any additional resources should be directed to the area of education and awareness for prospective franchisees which, in the final analysis, can do much more in preventing difficulties and hardships than is the case with more intrusive regulation.[305]

A further submission suggested that the establishment of a regulatory body would be premature, and that Manitoba should wait until there has been a chance to determine the effect of franchise legislation and to assess whether the need for a regulatory body exists. However, it was proposed that the enactment of franchise legislation may present an opportunity to educate prospective franchisees to avoid potential abuses. The submission noted that the Manitoba Government could prepare an instructional pamphlet directing franchisees to resources that they could employ to obtain information before purchasing a franchise; the franchisor would then be responsible to include the pamphlet with its disclosure document.[306]

The Commission shares the view that the establishment of a franchise regulatory body would be premature in Manitoba. A regulatory body would not have to be structured along the lines of a Securities Commission, and the problems experienced with the former Alberta regulatory model would not necessarily be repeated. As experience is gained with franchise legislation in Manitoba, a regulatory body may prove to be valuable. However, at this time, the establishment of a regulatory body has not been shown, or even argued, to be necessary, and the Commission makes no recommendation on this point.

The Commission also agrees with the respondents who recommended the development of education and awareness initiatives for franchisees. The Commission supports the suggestion that the Manitoba Government prepare educational material explaining franchising and franchise legislation, and directing franchisees to resources that might assist them. Such material might save prospective franchisees a great deal of money and stress. In the Commission's view, it would not be appropriate to require franchisors to include government material in their disclosure documents; the requirement may be impossible to achieve if a current government document is not available at the time of disclosure. The Commission has already recommended, however, that the risk warning in the disclosure document include a statement that franchising in Manitoba is governed by a franchise Act and regulations, and that franchisees and franchisors have specific legal rights and duties. The warning would also recommend that franchisees seek independent legal and financial advice.

RECOMMENDATION 56

The Government of Manitoba should conduct public awareness initiatives with respect to franchising, including preparing and distributing educational material that explains franchising and the rights and duties under franchise legislation and identifies resources that might assist prospective franchisees.

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[305] Submission by E. Levitt (July 19, 2007) at 3.

[306] Submission by B. Schwartz, J. Pozios and L. Zylberman (August 30, 2007).

S. CONSULTATION

1. Draft Regulations

The Commission received recommendations that the Manitoba Government follow the P.E.I. example and circulate draft regulations for consultation before the regulations are made.[307]

> While the format of the Uniform Franchises Act is currently widely accepted, due to the diversity, size and experience of franchisors and franchisees in Canada, and the large number of product and service industries participating in franchising, the content of the regulations requires more discussion.[308]

The Commission strongly supports this suggestion. As the Canadian Franchise Association observed, the specific wording of the regulations "can have significant unintended effects",[309] and several respondents expressed an interest in further input.

RECOMMENDATION 57

The Government of Manitoba should circulate draft franchise regulations for public consultation.

2. Governments and Stakeholders

During the 2008 Franchise Law Symposium, suggestions were made that the Manitoba Government work with the governments of other provinces and territories on an ongoing basis to ensure that franchise legislation and regulations are effective and as consistent as possible, and meet the needs of Canadian franchisees and franchisors. The Commission strongly supports this suggestion. The Commission also recommends that a process be established for ongoing consultation with stakeholder groups, such as the Manitoba Bar Association and representatives of Manitoba franchisees and franchisors.

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[307] Submission by the Canadian Franchise Association (July 30, 2007); submission by F. Zaid, A. Frith and D. Mochrie (July 30, 2007). The latter submission also suggested that proposed legislation be published for public commentary before introduction in the Legislature; the Commission has no difficulty with this suggestion, but notes the opportunity for public input during the review of Bills by the appropriate Committee of the Legislative Assembly.

[308] Submission by the Canadian Franchise Association (July 30, 2007) at 2.

[309] *Ibid*.

RECOMMENDATION 58

The Government of Manitoba should work with the governments of other provinces and territories to ensure that franchise legislation and regulations are effective and as consistent as possible among the jurisdictions and meet the needs of Canadian franchisees and franchisors.

RECOMMENDATION 59

The Government of Manitoba should establish a process for ongoing consultation with stakeholder groups such as the Manitoba Bar Association and representatives of Manitoba franchisees and franchisors.

CHAPTER 6

LIST OF RECOMMENDATIONS

1. Manitoba should enact legislation to regulate franchising. (p. 45)

2. The Uniform Law Conference of Canada *Uniform Franchises Act* ("the ULCC Model Bill") and *Disclosure Documents Regulation* ("the ULCC Model Regulation") should be used as the model structure for Manitoba franchise legislation and regulations. (p. 47)

3. The definition of "franchise" in the Act should be consistent with the definition in the ULCC Model Bill. (p. 49)

4. The Act should provide that it does not apply to:
    - an employer-employee relationship;
    - a partnership;
    - a cooperative association of independent businesses;
    - a relationship arising out of an oral agreement where no term or aspect of the agreement is in writing; or
    - an arrangement for the purchase and sale of a reasonable amount of goods at reasonable wholesale prices or a reasonable amount of services at a reasonable price. (p. 50)

5. The Act should exempt "leased department" arrangements from the requirement to provide disclosure but not generally from the application of the Act. (p. 51)

6. The Act should provide that, in addition to the financial statements, documents and other information specifically required by the Act or regulations, the disclosure document must contain all material facts. (p. 54)

7. The Act should adopt the definitions of "material fact" and "material change" used in the ULCC Model Bill. (p. 58)

8. Manitoba should make regulations adopting the ULCC Model Regulation approach to disclosure, subject to the specific modifications noted below. (p. 62)

9. The regulations should require, in addition to the requirements in the ULCC Model Regulation, disclosure of the business background of any individual who will have management responsibilities relating to the sale or operation of the franchise. (p. 63)

10. The regulations should require disclosure of the business background of a franchisor's associate and affiliate and of a director, general partner or officer of a franchisor's associate or affiliate. (p. 65)

11. The regulations should not require disclosure of the business background of a franchisor's broker or other person making representations for the purpose of granting or marketing a franchise (p. 65)

12. The regulations should require disclosure of the business background of a franchisor's predecessor and its directors, general partners and officers. A franchisor's predecessor is a person from whom the franchisor directly or indirectly acquired the majority of the franchisor's business assets in a transaction or a series of transactions partly or wholly completed within the 10 years immediately preceding the date of disclosure. (p. 66)

13. The regulations should require disclosure, with a concise description of details, of previous convictions in respect of which no pardon has been granted, administrative orders and penalties, findings of liability, settlements of civil proceedings on materially adverse terms (including the material terms) and bankruptcies in respect of:
    - the franchisor and its associates, affiliates and predecessors;
    - the directors, general partners and officers of the franchisor and its associates, affiliates and predecessors; and
    - any individual who will have management responsibilities relating to the sale or operation of the franchise. (p. 68)

14. The regulations should limit the time period for which disclosure is required in respect of administrative orders and civil actions to the 10 year period immediately before the date of disclosure. (p. 68)

15. The regulations should require disclosure of all fees and payments that the franchisee must pay to the franchisor or its associate or affiliate, with the exception of payments required to be collected by law on behalf of a municipal or provincial government or the federal government. The regulations should also require that the disclosure document include a statement advising franchisees that the franchisor may be required by law to collect additional payments on behalf of a municipal or provincial government or the federal government. (p. 69)

16. The regulations should provide that where a financial performance representation is included in the disclosure document, the document must contain, in addition to the information identified in the ULCC Model Regulation, reasonable cautionary language respecting the forward-looking nature of the information and identifying the material factors that could cause actual results to differ materially. (p. 71)

17. The regulations should provide that:
    - where a projection or forecast of financial performance is based on the actual experience of existing franchises or businesses of the franchisor or its associate or affiliate, the disclosure must include the percentage of each type of unit that achieved the results and state that results of a specific unit may vary;
    - where a projection or forecast of financial performance is based on the experience of a subgroup of units, the disclosure must include the nature and number of units forming the subgroup, the basis for selecting them and any characteristics of the units that may differ materially from the franchise unit being offered; and
    - where a projection or forecast of financial performance is based on businesses operated by the franchisor or its associate or affiliate, the disclosure must include reasonable details of the adjustments necessary to make the information relevant to franchised units. (p. 71)

18. The regulations should provide that:
    - where a projection or forecast of financial performance is made, it must be included in one place in the disclosure document, along with the supporting information required by the regulations;
    - where a projection or forecast of financial performance is not included in the disclosure document, the disclosure document must include a standard statement that:
        - the franchisor does not make or authorize anyone else to make projections or forecasts of financial performance;
        - if the franchisee acquires a franchise of the type being offered, the results will vary depending on location and other factors. (p. 72)

19. The regulations should require disclosure of information respecting rebates as set out in the ULCC Model Regulation, requiring franchisors to provide a description of their policies and practices regarding rebates, commissions or other benefits. The regulations should also require disclosure of whether the franchisor or any affiliate of the franchisor received rebates or benefits in the most recent fiscal year, whether the rebates or benefits formed a material part of the total revenue of the recipient for that year and whether and how any rebates and benefits were shared with any franchisees. (p. 74)

20. The regulations should require, in addition to the requirements of the ULCC Model Regulation,

- where a franchisee is granted an exclusive territory, disclosure of the boundaries of the territory or a description of who will determine the boundaries and how they will be determined;
- disclosure of the franchisor's policies and practices respecting the use by the franchisor and franchisees of alternative channels of distribution, such as the internet, catalogue sales, telemarketing or other direct marketing techniques, including disclosure with respect to whether the franchisor uses or reserves the right to use alternative distribution channels;
- where the franchisee is not granted an exclusive territory, the inclusion of an express statement to that effect, with warnings that the franchisee may face competition from other franchisees, licensees or affiliates, from units owned by the franchisor or an affiliate or from other franchisor or affiliate channels of distribution or competitive brands. (p. 75)

21. The regulations should require disclosure of those material licences, registrations and authorizations, and laws and regulations, that are specific to the type of business carried on by the franchise system. The regulations should also require that a statement be included in the disclosure document advising franchisees that additional licences, registrations and authorizations other than those identified may be required and that additional laws applying generally to businesses may apply. (p. 76)

22. The regulations should require that, where a franchise agreement contains no right or option to renew the agreement, the disclosure document must include a statement to that effect. (p. 77)

23. The regulations should require that disclosure include:
    - contact information for
        - all current Manitoba franchisees,
        - the 20 current franchisees that are geographically closest to the unit being offered,
        - all former franchisees that ceased operating in Canada within the previous year,
        - the 20 former franchisees that ceased operating within the previous year that are geographically closest to the unit being offered,
        - all current businesses of the same type as the unit being offered operated in Canada by the franchisor or its associate or affiliate,
        - the 20 current businesses of the same type as the unit being offered operated by the franchisor or its associate or affiliate that are geographically closest to the unit,
        - all former businesses of the same type as the unit being offered operated by the franchisor or its associate or affiliate that ceased operating in Canada within the previous year,
        - the 20 former businesses of the same type as the unit being offered operated by the franchisor or its associate or affiliate that ceased

operating within the previous year and are geographically closest to the unit;

- information in table format showing, without geographical restriction (identified by Canadian province or territory or, if outside Canada, by state, province or comparable jurisdiction)
  - the number of franchises and the number of businesses operated by the franchisor or its associate or affiliate operating at the end of each of the franchisor's last three fiscal years,
  - the number of franchises and the number of businesses operated by the franchisor or its associate or affiliate that were transferred during each of the franchisor's last three fiscal years,
  - the number of franchises and the number of businesses operated by the franchisor or its associate or affiliate that were operating at the beginning of each of the franchisor's last three fiscal years, those that were opened during each of the years and those that ceased operating (classified by the reason) during each of the years;
- estimates of
  - the number of units in Manitoba to be operated by franchisees that will be granted, and the number that will open for business, in the 12 months following the disclosure,
  - the number of businesses in Manitoba of the same type as the unit being offered to be operated by the franchisor or its associate or affiliate that will be established, and the number that will open for business, in the 12 months following the disclosure. (p. 79)

24. The regulations should require disclosure of the number of:
    - lawsuits that were initiated by the franchisor against franchisees in the 10 year period immediately preceding the date of disclosure;
    - franchisor–franchisee disputes that were resolved through mediation or arbitration in the 10 year period immediately preceding the date of disclosure;
    - franchisor–franchisee disputes that are pending in mediation or arbitration at the date of disclosure.

    The information should be identified by province and, if franchises are operated in other countries, by country. (p. 82)

25. The regulations should require disclosure of the number of current or former franchisees that are subject to confidentiality agreements, other than confidentiality agreements entered into solely for the purpose of providing pre-sale disclosure. The information should be identified by province and, if franchises are operated in other countries, by country. (p. 84)

26. The regulations should require disclosure of the history of the ownership and operation of the franchise outlet being offered, including whether the franchise is a resale by a

franchisee or has been acquired by the franchisor for resale, and any repeated sales of the franchise. The regulations should also require disclosure of repeated sales of other current franchises within Manitoba and of the 20 current franchises that are geographically closest to the franchise being offered. (p. 85)

27. The regulations should require disclosure of the resources and methods available for franchisee support, including any costs to be borne by the franchisee for the support. (p. 85)

28. The regulations should require disclosure of the business background of an individual or corporation that is related to the franchisor and that acts as the lessor or sub-lessor of the franchised premises. The regulations should also require disclosure of the matters set out in paragraphs 3 (c) to (f) of the ULCC Model Regulation. (p. 86)

29. The regulations should not require disclosure of the background, market conditions and risk factors relating generally to the nature of the business. (p. 87)

30. The regulations should require that a disclosure document include summaries of the franchisee's and franchisor's principal obligations under the franchise agreement, as well as a summary of the terms of the franchise agreement dealing with termination, transfer, assignment, renewal, expiry and alternative dispute resolution methods. (p. 87)

31. The regulations should require a risk warning at the beginning of a disclosure document, which should include the statements set out in the Ontario and P.E.I. regulations and the ULCC Model Regulation. The warning should also include a statement that franchisees and franchisors in Manitoba have specific rights and duties under the Act and regulations. (p. 88)

32. The regulations should allow the use of a disclosure document from a jurisdiction outside Manitoba if supplementary information is included that is necessary to comply with the Manitoba Act and regulations. (p. 90)

33. The regulations should require the disclosure document to be accurately, clearly and concisely set out. (p. 90)

34. The Act should provide that:
    - a disclosure document is valid if it substantially complies with the Act and regulations;
    - no disclosure document is invalid by reason of any informality or

technical irregularity or mistake not affecting the substance of the document. (p. 92)

35. The Act should authorize the delivery of a disclosure document personally, by registered mail or by any prescribed method. The regulations should authorize the delivery of a disclosure document by electronic means, as set out in the P.E.I. regulations, except that:
    - the consent of the prospective franchisee to electronic delivery should be required; and
    - receipt may be acknowledged by an electronic signature or other secure method of electronic acknowledgement. (p. 94)

36. The Act should provide an exemption from the advance disclosure requirement for site selection agreements and for confidentiality agreements restricting the release or use of disclosure information. The confidentiality agreement must not apply to information that is:
    - in the public domain;
    - disclosed with consent or without breaching the agreement; or
    - disclosed to other franchisees, to a franchisee organization or to the franchisee's professional advisors. (p. 96)

37. The Act should provide an exemption from the advance disclosure requirement for a fully refundable deposit that is placed with the franchisee's legal counsel or other independent advisor selected by mutual agreement. The deposit should be a maximum of 5% of the total franchise fee. If a franchise agreement is not executed within one year, the deposit should be fully refundable, with accrued interest refunded to the franchisee. If a franchise agreement is executed, accrued interest on the deposit should be credited to the franchisee. (p. 97)

38. The Act should provide an exemption from the disclosure requirement for the sale of a franchise by a franchisee as set out in the ULCC Model Bill. The Act should also provide that:
    - where the exemption does not apply, the franchisor is required to provide the disclosure;
    - the exemption does not apply where the franchisee is a director or officer of an affiliate of the franchisor;
    - the exemption may apply where a fee payable to the franchisor is referenced but ascertainable at a later date; and
    - the exemption does not apply where the franchisee is engaged in repeated franchise sales. (p. 98)

39. The Act should provide an exemption from the disclosure requirement for the sale of a franchise to an individual who has been a director or officer of the franchise, or has held regular management responsibilities in relation to the franchise, for a period of at least 24

months ending within 60 days of the sale of the franchise. (p. 99)

40. The Act should require franchisors to provide a current disclosure document to a franchisee considering a renewal or extension of a franchise agreement where:
    - there has been an interruption in the operation of the franchise exceeding a total of 60 days within the 24 months immediately preceding the renewal or extension;
    - a material change has occurred since the latest franchise agreement, renewal or extension was signed; or
    - the new agreement contains terms and conditions that differ materially from the most recent franchise agreement, renewal or extension. (p. 101)

41. The Act should require franchisors to provide a current disclosure document to a franchisee considering an additional franchise agreement where:
    - there has been an interruption in the operation of the existing franchise exceeding a total of 60 days within the 24 months immediately preceding the additional agreement;
    - a material change has occurred since the latest franchise agreement, renewal or extension was signed;
    - the additional agreement contains terms and conditions that differ materially from the most recent franchise agreement, renewal or extension; or
    - the additional franchise is not substantially the same as the existing franchise. (p. 102)

42. The Act should not authorize regulations to be made to provide for exemptions from the requirements of the Act or regulations. (p. 105)

43. The Act should include the provisions contained in the Model Bill with respect to the disclosure remedies available to franchisees. (p. 108)

44. The Act should preserve the rights and remedies that the parties to a franchise agreement may otherwise have at law. (p. 108)

45. The Act should provide that the statutory remedy of damages for misrepresentation applies to future projections and forecasts. (p. 111)

46. The Act should provide that a person is not liable in an action under the Act for misrepresentation in a future projection or forecast if:
    - the disclosure document contained the information required by the regulations, including reasonable cautionary language identifying the

representation as a future projection or forecast and identifying material factors that could cause actual results to differ materially; and

- the person had a reasonable basis for making the projection or forecast. (p. 112)

47. The Act should impose on parties to a franchise agreement a duty of fair dealing in the performance and enforcement of the agreement, including in the exercise of a right under the agreement, as provided in the ULCC Model Bill. The duty should include the duty to act in good faith and in accordance with reasonable commercial standards. The Act should provide for a right of action for damages by a party to a franchise agreement against another party who breaches the duty of fair dealing. (p. 114)

48. The Act should protect the right of franchisees to associate with other franchisees and to form or join an organization of franchisees, in a manner consistent with the ULCC Model Bill. The Act should contain provisions consistent with the Model Bill to:

    - prohibit franchisors from penalizing or interfering with franchisees who exercise the right to associate;
    - provide that a provision in an agreement purporting to restrict a franchisee from exercising the right is void; and
    - provide that a franchisee has a right of action for damages for a contravention of the prohibition.

    The Act should also prohibit franchisors from interfering with communications between prospective franchisees and current or past franchisees. With respect to current franchisees, the right to associate should apply retroactively to franchise agreements entered into before the Act comes into force. (p. 115)

49. The Act should provide that any pre-dispute waiver or release by a franchisee or prospective franchisee of a right or requirement under the Act or regulations is void. The provision should apply retroactively to franchise agreements entered into before the Act comes into force. The Act should allow franchisees to waive a right or requirement under the Act or regulations in relation to a dispute in the context of a post-dispute settlement agreement. (p. 117)

50. The Act should expressly bind the Crown, but exempt the Crown from including in its disclosure document the financial statements otherwise required by the Act. (p. 118)

51. The Act should provide that any provision in a franchise agreement that purports to restrict the application of the law of Manitoba or to restrict jurisdiction or venue to a forum outside Manitoba is void with respect to a claim otherwise enforceable under the Act in Manitoba. (p. 118)

52. The Act should include provisions to:

- prohibit a party to a franchise agreement from terminating the franchise agreement without just cause and provide a right of action for damages for a contravention of this provision;
- require a party to a franchise agreement to allow the other party a reasonable time to remedy a breach of the franchise agreement after receiving written notice – exceptions should be provided for breaches that are not curable, such as bankruptcy or abandonment of the franchised premises;
- where a franchise agreement does not include an option to renew, prohibit a franchisor from failing to renew the agreement without just cause – where the franchisor is withdrawing from a geographic market the franchisor should be required to compensate the franchisee and a non-competition covenant should be unenforceable;
- provide that the fact that a franchise agreement authorizes a franchisor to unilaterally vary a term or condition of the agreement is a factor that a court may consider when determining whether the franchisor has complied with the duty of fair dealing;
- provide that where the terms of a franchise agreement are materially changed by the franchisor on renewal and agreement cannot be reached as to the terms, the franchisor must buy back the franchise at the original purchase price or release the franchisee from the franchise agreement;
- provide that a franchisor's approval for the sale or transfer of a franchise may only be withheld on reasonable grounds and that a franchisor may not require, as a condition of the transfer, that the franchisee undertake obligations or relinquish rights unrelated to the franchise being transferred or enter into a release of claims that is broader than a release entered into by the franchisor;
- provide that where a franchise is sold or transferred, the liability of the original franchisee does not extend beyond the terms of that franchisee's agreement;
- provide that a franchisee may purchase goods or services from sources other than those designated by the franchisor where the goods or services are of comparable quality – exceptions should be provided for goods or services that are central to the franchised business and are manufactured or produced by the franchisor or franchisor's associate or that incorporate a trade secret owned by the franchisor or franchisor's associate; and
- provide that where a franchise agreement provides for an exclusive territory, a franchisee has a cause of action for damages if a franchisor allows encroachment, including competition by corporate units and internet and direct sales methods, that adversely affects the franchisee's sales. (p. 126)

53. The regulations should require that a disclosure document include a statement that advises that mediation is a voluntary process to resolve disputes with the assistance of a third party,

any party may propose mediation and the process may be used if agreed to by all parties. (p. 132)

54. The regulations should provide that where a franchise agreement contains provisions for arbitration or mediation, thorough disclosure of all elements of the process must be provided, including the methods and criteria for selecting a mediator or arbitrator, governing rules and procedures, costs, location or venue and confidentiality. (p. 132)

55. The Act should provide that:
    - a provision in a franchise agreement that requires that disputes between the parties be submitted to arbitration is invalid insofar as it prevents a franchisee from commencing or becoming a member of a class proceeding;
    - a franchisee may commence or become a member of a class proceeding in respect of a dispute between parties to a franchise agreement despite any provision in a prior agreement that purports to preclude class proceedings. (p. 138)

56. The Government of Manitoba should conduct public awareness initiatives with respect to franchising, including preparing and distributing educational material that explains franchising and the rights and duties under franchise legislation and identifies resources that might assist prospective franchisees. (p. 141)

57. The Government of Manitoba should circulate draft franchise regulations for public consultation. (p. 142)

58. The Government of Manitoba should work with the governments of other provinces and territories to ensure that franchise legislation and regulations are effective and as consistent as possible among the jurisdictions and meet the needs of Canadian franchisees and franchisors. (p. 143)

59. The Government of Manitoba should establish a process for ongoing consultation with stakeholder groups such as the Manitoba Bar Association and representatives of Manitoba franchisees and franchisors. (p. 143)

This is a report pursuant to section 15 of *The Law Reform Commission Act*, C.C.S.M. c. L95, signed this 20th day of May 2008.

"Original Signed by"
Cameron Harvey, President

"Original Signed by"
John C. Irvine, Commissioner

"Original Signed by"
Gerald O. Jewers, Commissioner

"Original Signed by"
Alice R. Krueger, Commissioner

"Original Signed by"
Perry W. Schulman, Commissioner

APPENDIX A

CONSULTATION PAPER RESPONDENTS

Association of Equipment Manufacturers

Canadian Federation of Independent Grocers

Canadian Franchise Association

Ann Donald, Ann's Academy Florist

Independent Retail Grocers' Association

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Terry Halligan

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Bruce Macallum

Manitoba Farm Machinery Board

Manitoba Motor Dealers Association Inc.

Bryan Schwartz, John Pozios and Leandro Zylberman, University of Manitoba Faculty of Law

The TDL Group Corp. (Tim Hortons)

A. Lionel Weinberg, Q.C., Myers Weinberg LLP

Frank Zaid, Andraya Frith and Dominic Mochrie, Osler Hoskin & Harcourt LLP

APPENDIX B

2008 FRANCHISE LAW SYMPOSIUM PANELISTS
MARCH 14, 2008

Thomas G. Frohlinger, Pullan Kammerloch Frohlinger

Ben V. Hanuka, Goldman Sloan Nash & Haber LLP

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FRANCHISE LAW

EXECUTIVE SUMMARY

A. INTRODUCTION

This report considers whether legislation to regulate franchising should be enacted in Manitoba. It provides an introduction to franchising, an overview of existing franchise regulation in Canada and other countries and a review of the elements of Canadian legislative regimes. The Commission recommends the enactment of franchise legislation in Manitoba and makes a number of further recommendations that Commissioners believe will protect the interests of franchisees and enable them to make more informed business decisions, while recognizing the commercial interests of franchisors.

B. FRANCHISING OVERVIEW

A franchise is a contract between two businesses, in which the franchisor grants the franchisee the right to operate its business system in return for payment of fees and royalties. The business system typically includes intellectual property, the right to sell products or services, access to business knowledge and methods and other assets. The franchisor often provides continuing support and direction, and the franchisee agrees to comply with the franchisor's standards and usually, to operate in a way that is substantially similar to or indistinguishable from the operation of other franchises in the system. Franchising has become a common distribution method chosen by businesses, and now represents a substantial portion of the Canadian economy.

A significant attraction of franchising for the franchisee is the opportunity to enter the marketplace with reduced business risks, where there is an established franchisor that offers a successful business system. For the franchisor, franchising allows business expansion with little capital investment and provides an ongoing source of revenue from franchise fees or royalties. However, the franchise model also has disadvantages. The franchisor gives up some control and profit opportunity and its reputation can be at risk. As a result, the franchisor will usually attempt to ensure that each franchisee complies strictly with the franchisor's operational methods. The bargaining power of the parties to a franchise relationship may be dramatically unequal. The franchisor generally has more extensive business and franchising experience and has control over the terms of the franchise agreement, while the franchisee often must ‘take or leave’ the franchise agreement as offered. The franchisee must rely to some extent on the franchisor’s representations about the franchise, and continues to be at a disadvantage in terms of access to information and control of operations throughout the franchise relationship.

Areas of conflict that have been found to arise between the parties to a franchise relationship include lack of pre-contract disclosure, misrepresentation about aspects of the franchise, excessive prices for goods, equipment and services obtained from the franchisor or from required suppliers, encroachment and franchisor-imposed system wide changes.

In the absence of legislation, the franchise relationship is governed by the terms of the agreement and the law of contract. The characteristics of the relationship also give rise to a common law duty upon the parties to act in good faith.

C. CANADIAN FRANCHISE REGULATION

Four provinces have taken legislative measures to regulate franchising activity. Alberta was the first to enact franchise legislation, in 1971. The Act was a registration statute that required franchisors to register with the Alberta Securities Commission and to file certain documents, including a prospectus. However, by the late 1980s, concerns had arisen about the registration and disclosure requirements, and in 1995, the Act was replaced by a new *Franchises Act* and regulations.

The 1995 Alberta Act is a disclosure statute; it requires franchisors to provide financial and other material fact disclosure to prospective franchisees, but does not require franchisor registration or document filing. The Act also includes provisions governing the franchise relationship, imposing a duty of fair dealing and protecting the freedom of franchisees to associate.

Ontario was the second province to enact franchise legislation, the *Arthur Wishart Act (Franchise Disclosure) 2000*. The Ontario Act is a disclosure statute based largely on the 1995 Alberta Act, and similarly provides for a duty of fair dealing and the right to associate. The Act does not provide for document registration or government oversight.

In August 2005, the Uniform Law Conference of Canada (ULCC) adopted the *Uniform Franchises Act* (the Model Bill) and regulations and recommended them to the provinces and territories for enactment. The Model Bill and regulations are based primarily on Ontario's Act and regulations; a mediation process is also included that is mandatory if a party to the franchise agreement initiates it.

Prince Edward Island enacted the *Franchises Act*, modeled primarily on the ULCC Model Bill, in June 2005. New Brunswick's *Franchises Act* received Royal Assent in June, 2007, and is not yet in force. The Act is a disclosure statute based closely on the ULCC Model Bill, and provides for a similar mediation process.

All Canadian franchise statutes require franchisors to disclose specific detailed information, including financial statements and the background of the franchisor, to prospective franchisees at least 14 days before the franchisee signs a franchise agreement or pays money toward the franchise. Franchisors must also disclose all material facts that would reasonably be expected to have a significant effect on the value or price of the franchise or the decision to acquire the franchise. A franchisee has the right to rescind the franchise agreement within 60 days if the franchisor fails to provide the disclosure document within the time required or if the contents of the disclosure document do not meet the statutory requirements. Where the franchisor provides no disclosure document, the franchisee may rescind the franchise agreement within two

years. The franchisee also has a right of action for damages if the franchisee suffers a loss because of a misrepresentation in the disclosure document or because of the franchisor's failure to comply with the disclosure requirements.

The legislation also imposes a duty on the parties to a franchise agreement to deal fairly, and protects the right of franchisees to associate with other franchisees. No Canadian statutes provide for government registration or oversight.

D. INTERNATIONAL FRANCHISE REGULATION

In the United States, franchising is regulated by the federal government and by several state governments. Federally, franchise sales are regulated by the Federal Trade Commission Franchise Disclosure Rule. The FTC Rule requires franchisors to make detailed disclosures to prospective franchisees at least 10 business days before the franchisee pays any consideration toward the franchise or signs a contract. The Rule contains no express duty of good faith or fair dealing, and there is no filing or registration requirement. Beginning on July 1, 2008, U.S. franchisors will be required to comply with a revised FTC Rule, which adopts more extensive disclosure requirements.

In addition, several states have franchisor registration requirements modeled after securities legislation; franchisors must register with a state agency and obtain approval before offering their franchises. Several states have also enacted franchise relationship legislation to govern the relationship between the parties after the franchise agreement is signed. All of these statutes have provisions governing termination of the franchise agreement; other matters include contract renewal and transfer, territory encroachment and the purchase of goods and services from designated sources of supply.

In Australia, a mandatory Franchising Code of Conduct requires franchisors to provide disclosure at least 14 days before an agreement is signed or a non-refundable payment is made. The Code also provides for a seven day cooling-off period and mandatory mediation for dispute resolution. The Code protects the right of franchisees to associate and requires franchisors to give franchisees up to 30 days to remedy a breach before an agreement can be terminated.

E. MANITOBA FRANCHISE REGULATION

The threshold question considered by the Commission was whether legislation to regulate franchising is desirable for Manitoba. The principal argument against franchise legislation is that it may tend to have a chilling effect on the attractiveness of Manitoba as a business location. However, franchising regulatory restrictions now exist in four Canadian provinces and in the U.S., and the lack of regulation in Manitoba places prospective franchisees at a significant disadvantage in comparison to these provinces. Experience in other jurisdictions suggests that regulation may benefit the franchise industry as a whole, while a choice not to regulate may risk the development of a reputation for Manitoba as a haven for incompetent or disreputable

franchisors. In the Commission's opinion, legislation to regulate franchising is clearly appropriate for Manitoba.

The Commission recognizes that consistency among the Canadian franchise statutes will increase certainty within the business environment. However, the existing franchise statutes are similar, but not uniform, and the Ontario Bar Association has recently made a number of recommendations for improvements to the Ontario regulation that, if adopted, would result in significant amendments. In the Commission's view, the ULCC Model Bill and disclosure regulation offer a useful model for Manitoba franchise legislation. However, recognizing the imbalance of power inherent in the franchise relationship, the Commission also makes additional recommendations that we believe will ensure that full information is provided to a prospective franchisee before the purchase of the franchise and provide a measure of protection for franchisees throughout the franchise relationship.

In general, the Commission is in favour of thorough pre-sale disclosure to prospective franchisees, and supports the requirement that the franchisor disclose all “material facts” relating to the franchise. The Commission also makes several recommendations with respect to specific franchisor disclosure obligations. In the Commission's view, the requirement under current franchise statutes to disclose specific background information with respect to the directors, general partners and officers of the franchisor should be extended to disclosure respecting all individuals who have management responsibility relating to the franchise, to ensure that full disclosure is not precluded by avoiding the use of a formal title. The disclosure requirement should also be extended to affiliates of a franchisor, who are significantly connected to the franchisor through relationships of control. As well, under the current requirements, a franchisor could avoid disclosing unfavourable background information by assuming a new corporate identity. As a result, the Commission recommends extending the disclosure requirements to a franchisor's predecessors.

The Commission also makes recommendations to clarify the level and extent of disclosure required with respect to financial performance representations, and to require that cautionary language be included in the disclosure document. Where a projection or forecast of financial performance is not included in a disclosure document, the document should include a statement that no one is authorized to make projections or forecasts respecting the franchise.

Under the ULCC Model Bill, franchisors are required to disclose their policies and practices in relation to rebates and other benefits received as a result of purchases made by franchisees to designated suppliers. The Commission recommends that franchisors also be required to disclose whether the franchisor or any affiliate of the franchisor in fact received rebates or benefits in the previous year, whether the benefits formed a material part of the recipient’s total revenue and whether and how rebates were shared with franchisees. The Commission recommends more detailed disclosure with respect to exclusive territories, and where an exclusive territory is not granted, that an express statement to that effect be required.

The Commission considered whether additional categories of disclosure should be included to help to inform franchisees about the nature of the relationship that may be expected with the franchisor and to provide more detailed information about the specific franchise outlet.

In the Commission's view, the regulations should require disclosure of the number of lawsuits initiated by the franchisor against franchisees and the number of disputes that were resolved through mediation or arbitration. As well, franchisees should receive information as to the number of current or former franchisees that are subject to confidentiality agreements, to assist franchisees to evaluate the extent and quality of information that may be obtained by contacting others in the franchise system. Significant turnover at a franchise location or in an area may also be revealing information for a prospective franchisee; the Commission recommends that disclosure be required of the history of the franchise outlet being offered and of the closest other outlets.

It was suggested to the Commission that, given the impact of the landlord-tenant relationship on the business affairs of a franchise, particularly with the common use of cross-default provisions in franchise and lease agreements, disclosure should be required where an individual or corporation that is related to the franchisor acts as sub-lessor of the premises. The Commission agrees, and recommends that disclosure of the background of the sub-lessor be required where it is related to the franchisor.

The Commission considered whether franchisors should be authorized to use disclosure documents authorized under the law of another jurisdiction, if supplementary information is included that is necessary to comply with the Manitoba Act and regulations. The Commission agrees that the use of such "wrap-around documents" would be consistent with the goal of harmonization among the provinces and may help to limit any additional costs that franchisors might incur in complying with Manitoba's requirements. As well, the Commission is persuaded that it is appropriate to provide some relief for franchisors for minor errors or irregularities in a disclosure document, and recommends that the regulations provide that a disclosure document is valid if it substantially complies with the Act and regulations.

Currently, Prince Edward Island is the only Canadian jurisdiction to authorize the electronic delivery of disclosure documents. Electronic delivery is consistent with Manitoba's *Electronic Commerce and Information Act*, and with current commercial practices, and may help to reduce franchisor compliance costs. However, a franchisee should have the right to receive delivery in paper form if requested.

The Commission makes several recommendations with respect to circumstances in which an exemption should be made from the 14 day advance disclosure requirement. For example, a franchisor should be able to enter into a site selection agreement (reserving a franchise site) or require a prospective franchisee to enter into a confidentiality agreement respecting the information to be provided before providing disclosure. The Commission is of the view that an exemption is also appropriate for a fully refundable deposit, within a maximum amount, if it is placed with an independent advisor.

The Commission considered whether authority should be provided, as in other Canadian franchise statutes, for regulations to be made exempting franchisors from any or all of the provisions of the Act or regulations. In Alberta, Ontario and P.E.I., regulations have been made providing for exemptions for "mature franchisors" from the requirement to include financial statements in a disclosure document. On balance, the Commission is not persuaded that "mature

franchisors" are immune from subsequent financial or ethical difficulties, and recommends that the Manitoba Act not provide authority to make such regulations.

Canadian franchise statutes provide remedies for franchisees where a franchisor fails to comply with the disclosure requirements; a franchisee has a right of rescission where there has been no or inadequate disclosure and a right of action for damages if the franchisee suffers a loss because of a misrepresentation or a failure to comply with the disclosure requirements. The statutes also preserve any other rights and remedies otherwise available to the parties at law. The Commission is of the view that Manitoba franchise legislation should maintain consistency with the ULCC Model Bill with respect to the statutory disclosure remedies and the preservation of common law rights and remedies. However, the Commission also recommends that Manitoba legislation clarify that the statutory remedy of damages for misrepresentation applies to future projections and forecasts.

The Commission recommends consistency with the other franchise statutes with respect to the duty of fair dealing and the protection of the right of a franchisee to associate with other franchisees. Other franchise statutes also provide that a waiver or release by a franchisee of a right or requirement under the Act or regulations is void. While the Commission agrees with this prohibition in principle, in our view there is a distinction between a waiver of rights that is given before a dispute arises and a waiver of rights given in the settlement of a dispute that later transpires. In order to enable franchisees and franchisors to settle their disputes, the Committee recommends that the Act allow franchisees to waive a right or requirement under the Act or regulations in the context of a settlement agreement.

Canadian franchise legislation includes limited provisions to regulate the relationship between the parties to a franchise agreement, such as the duty of fair dealing. In some jurisdictions, particularly in some U.S. states and in Australia, legislation places additional restrictions on the terms that a franchisor may include in an agreement, changes a franchisor may impose or actions it may take. The Commission recognizes that there are differing and strongly held views within the franchise community with respect to relationship regulation. However, in the Commission's opinion, the imbalance of power between the parties during negotiations and inherent in the franchise relationship requires that some conduct obligations be specified in legislation. Where appropriate, the obligations should be reciprocal. The Commission makes several recommendations for provisions to be included in Manitoba franchise legislation with respect to the franchise relationship, including restrictions on the termination of or failure to renew a franchise agreement, a requirement for reasonable time to remedy a breach, a provision allowing a franchisee to purchase goods and services from suppliers other than those designated by the franchisor, under certain circumstances, and a provision for a cause of action for damages for encroachment.

The Commission carefully considered whether Manitoba franchise legislation should provide for an alternative dispute resolution process. However, the Commission does not consider that that such a provision is appropriate at this time. The Commission supports the voluntary use of alternative dispute resolution mechanisms, and notes that pre-trial mediation is a common practice of the Manitoba Court of Queen's Bench. Where a franchise agreement

contains provisions for alternative dispute resolution, thorough disclosure of all elements of the process should be required.

While the Commission supports the use of alternative dispute resolution mechanisms, the impact of mandatory arbitration provisions on the availability of class proceedings merits further consideration. Franchise agreements are generally contracts of adhesion, and franchisees rarely have the opportunity to influence the terms of the agreement or to choose freely whether to settle any disputes that arise by arbitration. Where mandatory arbitration clauses preclude class proceedings, they may effectively deny access to justice for franchisees whose individual claims do not justify the cost, time or effort of arbitration. In the Commission's opinion, Manitoba franchise legislation should provide that a mandatory arbitration clause in a franchise agreement is invalid insofar as it prevents a franchisee from participating in a class proceeding.

The Commission considered the question of whether a franchise regulatory body should be established in Manitoba. In our view, the establishment of such a body would be premature, and is not recommended. The Commission does recommend that the Manitoba Government conduct public awareness initiatives with respect to franchising, including preparing and distributing educational material that explains franchising and franchise legislation and identifies resources that might assist prospective franchisees.

The Commission recommends that the Manitoba Government follow the P.E.I. example and circulate draft regulations for consultation before the regulations are made. The Commission also urges the Government of Manitoba to work with the governments of other provinces to ensure that franchise legislation and regulations are as effective and consistent among jurisdictions as possible, and to establish a process for ongoing consultation with stakeholder groups in Manitoba.

DROIT DES FRANCHISES

RÉSUMÉ

A. INTRODUCTION

Le présent rapport porte sur l'opportunité de l'adoption d'une loi régissant le franchisage au Manitoba. Il comprend une introduction au franchisage, un aperçu des règlements existants sur le franchisage au Canada et dans d'autres pays, ainsi qu'un examen des éléments constitutifs des régimes législatifs canadiens. La Commission préconise l'adoption d'une loi sur le franchisage au Manitoba et fait d'autres recommandations qui, de l'avis des commissaires, protégeront les intérêts des franchisés et leur permettront de prendre des décisions opérationnelles plus éclairées, tout en tenant compte des intérêts commerciaux des franchiseurs.

B. APERÇU DU FRANCHISAGE

Une franchise est une entente conclue entre deux entreprises, par laquelle le franchiseur accorde au franchisé le droit d'exploiter son système opérationnel en contrepartie du versement de droits et de redevances. Le système opérationnel comprend habituellement les droits de propriété intellectuelle, le droit de vendre des produits ou des services, ainsi que l'accès à des connaissances opérationnelles, aux pratiques commerciales et à d'autres éléments d'actif. Le franchiseur fournit souvent du soutien et de l'orientation continus, et le franchisé convient de se conformer aux normes et aux méthodes opérationnelles du franchiseur. Le franchisage est devenu la méthode courante de distribution que choisissent les entreprises et il représente actuellement une partie importante de l'économie canadienne.

Un attrait important du franchisage pour le franchisé est l'occasion de pénétrer sur le marché avec des risques commerciaux moindres, là où il y a un franchiseur établi qui offre un système opérationnel rentable. Pour le franchiseur, le franchisage permet le développement de l'entreprise avec des dépenses en immobilisations moins élevées et il fournit une source permanente de revenus grâce aux droits et redevances qui lui sont versés. Toutefois, le modèle de franchise comporte également des inconvénients. Le franchiseur abandonne une certaine quantité de contrôle et une possibilité de profit; il se peut aussi que sa réputation soit menacée. En conséquence, le franchiseur visera, en général, à ce que le franchisé respecte de façon stricte les méthodes opérationnelles du franchiseur. Le pouvoir de négociation des parties à une relation franchiseur/franchisé peut être très inégal. En règle générale, le franchiseur possède une vaste expérience en affaires et dans le domaine du franchisage et il exerce un contrôle sur les conditions du contrat de franchisage, alors que le franchisé doit souvent « accepter ou refuser » le contrat de franchisage comme il est offert. Le franchisé doit s'en remettre, dans une certaine mesure, aux déclarations faites par le franchiseur en ce qui concerne la franchise, et le franchisé continue d'être désavantagé en termes d'accès à l'information et de contrôle des activités pendant toute la relation franchiseur/franchisé.

Parmi les sources de conflit qui se produisent entre les parties à une relation franchiseur/franchisé, citons le manque de divulgation de renseignements avant la signature du contrat, la présentation inexacte de certains aspects de la franchise, les prix excessifs des biens, de l'équipement et des services obtenus auprès du franchiseur ou des fournisseurs requis, l'empiètement sur le territoire et les changements apportés dans tout le système et qui sont imposés par le franchiseur.

En l'absence d'une loi, la relation franchiseur/franchisé est régie par les conditions du contrat et par le droit des contrats. Les caractéristiques de la relation donnent également lieu à une obligation de common law qui impose aux parties d'agir de bonne foi.

C. RÉGLEMENTATION CANADIENNE SUR LE FRANCHISAGE

Quatre provinces ont adopté des mesures législatives en vue de réglementer l'activité de franchisage. L'Alberta a été la première à adopter une loi sur le franchisage, en 1971. La loi était une mesure sur l'enregistrement qui exigeait des franchiseurs de s'enregistrer auprès de la Alberta Securities Commission et de déposer certains documents, notamment un prospectus. Toutefois, à la fin des années 1980, des préoccupations ont été exprimées à propos des exigences sur l'enregistrement et les obligations d'information et, en 1995, la loi a été remplacée par une nouvelle loi sur le franchisage et un nouveau règlement d'application.

La loi de 1995 de l'Alberta est une loi sur la divulgation qui impose aux franchiseurs de fournir des divulgations financières ou autres faits importants pour les franchisés éventuels mais sans exiger d'enregistrement ou de dépôt de documents de la part du franchiseur. La loi inclut aussi des dispositions sur la relation franchiseur/franchisé qui imposent une obligation d'agir équitablement tout en protégeant la liberté des franchisés de s'associer.

L'Ontario a été la seconde province à adopter une loi sur le franchisage, la *Loi Arthur Wishart de 2000 sur la divulgation relative aux franchises*. La loi ontarienne est une loi sur la divulgation qui est fondée en grande partie sur la loi de l'Alberta de 1995 et qui prévoit de la même manière une obligation d'agir équitablement et un droit d'association. La loi ne prévoit pas d'enregistrement de documents ou de surveillance par le gouvernement.

En août 2005, la Conférence pour l'harmonisation des lois au Canada (CHLC) a adopté la *Loi uniforme sur les franchises* (le modèle de projet de loi) et son règlement d'application, qu'elle a recommandés pour adoption aux provinces et aux territoires. Le modèle de projet de loi et son règlement d'application sont fondés principalement sur la loi de l'Ontario et son règlement d'application. Une procédure de médiation est aussi incluse et elle a force obligatoire si une partie au contrat de franchisage la met en œuvre.

L'Île-du-Prince-Édouard a adopté, en juin 2005, la *Franchises Act* inspirée du projet de loi modèle de la CHLC. La *Loi sur les franchises* du Nouveau-Brunswick a reçu la sanction royale en juin 2007 et elle n'est pas encore en vigueur. La *Loi* est une loi sur la divulgation qui est fondée de façon étroite sur le modèle de projet de loi de la CHLC et qui prévoit une procédure de médiation similaire.

Au Canada, toutes les lois sur le franchisage exigent des franchiseurs qu'ils divulguent des renseignements détaillés particuliers, notamment les états financiers et l'information sur les antécédents du franchiseur aux franchisés éventuels, au moins 14 jours avant que le franchisé ne signe un contrat de franchisage ou ne verse d'argent pour la franchise. Les franchiseurs doivent aussi divulguer tous les faits importants dont il est raisonnable de s'attendre qu'ils auront un effet significatif sur la valeur ou le prix de la franchise à concéder ou sur la décision de l'acquérir. Le franchisé a le droit de résoudre le contrat de franchisage dans un délai de 60 jours si le franchiseur omet de remettre au franchisé le document d'information dans le délai imparti ou si le contenu du document d'information ne satisfait pas aux exigences de la loi. Lorsque le franchiseur ne remet pas de document d'information, le franchisé peut résoudre le contrat de franchisage dans un délai de deux ans. Le franchisé a aussi le droit d'intenter une action en dommages-intérêts s'il subit une perte en raison d'une présentation inexacte des faits dans le document d'information ou parce que le franchiseur ne s'est pas conformé aux obligations d'information.

La législation impose une obligation aux parties à un contrat de franchisage d'agir équitablement et protège le droit des franchisés de s'associer à d'autres franchisés. Aucune loi canadienne ne prévoit d'inscription au gouvernement ou de surveillance par le gouvernement.

D. RÉGLEMENTATION INTERNATIONALE SUR LE FRANCHISAGE

Aux États-Unis, le franchisage est réglementé par le gouvernement fédéral et par différents gouvernements d'États. À l'échelon fédéral, les ventes de franchises sont réglementées par la *Franchise Disclosure Rule* de la Federal Trade Commission. La règle de la FTC exige des franchiseurs qu'ils divulguent des renseignements détaillés aux franchisés éventuels au moins 10 jours ouvrables avant le versement par le franchisé de toute contrepartie relative à la franchise ou la signature d'un contrat. La règle ne prévoit pas d'obligation expresse d'agir de bonne foi ou d'agir équitablement ni d'exigences de dépôt ou d'enregistrement. À compter du 1er juillet 2008, les franchiseurs aux États-Unis seront tenus de respecter une règle de la FTC révisée, qui impose des obligations d'information plus étendues.

De plus, plusieurs États exigent l'inscription des franchiseurs qui s'inspirent de la loi sur les valeurs mobilières; les franchiseurs doivent s'inscrire auprès d'une agence d'État pour obtenir une approbation avant de pouvoir offrir leur franchise. Plusieurs États ont aussi adopté une loi sur la relation franchiseur/franchisé qui gouverne la relation entre les parties une fois la signature du contrat de franchisage. Toutes ces lois contiennent des dispositions sur la résiliation du contrat de franchisage et, entre autres questions, sur le renouvellement et le transfert des contrats, l'empiètement du territoire et l'achat de biens et de services auprès de sources d'approvisionnement désignées.

En Australie, un code de conduite à caractère obligatoire sur la franchise impose aux franchiseurs de divulguer des renseignements au moins 14 jours avant la signature de tout contrat ou le versement de toute somme non remboursable. Le code prévoit aussi un délai de réflexion de sept jours et une médiation obligatoire pour le règlement des différends. Le code protège les

droits des franchisés de s'associer et exige des franchiseurs qu'ils donnent aux franchisés un délai maximal de 30 jours pour remédier à toute violation avant de résilier un contrat.

E. RÉGLEMENTATION SUR LE FRANCHISAGE AU MANITOBA

La question préliminaire examinée par la Commission était de savoir si une loi visant à réglementer le franchisage était souhaitable pour le Manitoba. Le principal argument contre la loi sur le franchisage veut qu'elle puisse éventuellement avoir un effet paralysant sur l'intérêt que présente le Manitoba comme lieu de commerce pour les franchiseurs. Toutefois, des exigences réglementaires existent maintenant dans quatre provinces canadiennes et aux États-Unis, et le manque de réglementation au Manitoba place les franchisés éventuels dans une situation nettement défavorisée par rapport à celle des autres provinces. L'expérience dans d'autres ressorts montre que la réglementation peut être profitable pour toute l'industrie du franchisage, alors que le choix de ne pas réglementer peut risquer de faire naître une réputation pour le Manitoba comme étant un refuge pour les franchiseurs incompétents ou de réputation douteuse. De l'avis de la Commission, une loi visant à réglementer le franchisage est clairement appropriée pour le Manitoba.

La Commission reconnaît que la cohérence entre les lois sur le franchisage au Canada augmentera la confiance dans l'environnement commercial. Toutefois, bien que les lois existantes sur le franchisage soient similaires, il n'y a pas d'uniformité. De la même manière, l'Association du Barreau de l'Ontario a récemment fait un certain nombre de recommandations pour améliorer la réglementation de l'Ontario, lesquelles, si elles sont adoptées, entraîneront des modifications importantes. De l'avis de la Commission, le modèle de projet de loi de la CHLC et le règlement sur la divulgation constituent des modèles utiles pour le Manitoba. Toutefois, la Commission, tout en reconnaissant le déséquilibre de pouvoir qui est inhérent à la relation franchiseur/franchisé, fait cependant des recommandations supplémentaires qui, selon nous, garantiront que toute l'information est bien remise à un franchisé éventuel avant l'achat de la franchise et donneront une certaine protection aux franchisés au cours de toute la relation franchiseur/franchisé.

En général, la Commission est en faveur d'une divulgation intégrale avant la vente aux franchisés éventuels et elle préconise que le franchiseur divulgue tous les « faits importants » concernant la franchise. La Commission fait aussi plusieurs recommandations sur les obligations de divulgation spécifiques du franchiseur. De l'avis de la Commission, l'obligation que contiennent les lois sur le franchisage en vigueur en matière de divulgation de renseignements précis sur les antécédents des administrateurs, des commandités et des dirigeants du franchiseur devrait être étendue à la divulgation concernant toutes les personnes chargées de la gestion dans la franchise; cela permettrait d'éviter que l'on se dérobe à la divulgation complète en n'utilisant pas de titre officiel. De la même manière, aux termes des exigences actuelles, le franchiseur pourrait s'abstenir de divulguer des renseignements défavorables sur les antécédents en adoptant une nouvelle image de marque. La Commission recommande d'étendre les obligations d'information aux prédécesseurs et aux sociétés affiliées d'un franchiseur.

La Commission fait aussi des recommandations pour clarifier le niveau et la portée de la divulgation exigée en ce qui concerne les projections de bénéfices et pour que le document d'information présente les projections avec une formulation prudente. Lorsque ce document ne comporte pas de projection ou de prévision du rendement financier, il faudrait qu'il comporte une déclaration selon laquelle personne n'est autorisé à faire des projections ou des prévisions en ce qui concerne la franchise.

Selon le modèle de projet de loi de la CHLC, les franchiseurs sont tenus de divulguer leurs politiques et pratiques en relation avec les rabais ou autres avantages reçus à la suite d'achats faits par les franchisés à des fournisseurs désignés. La Commission recommande que les franchiseurs soient aussi tenus de dire si le franchiseur ou une société affiliée de celui-ci a reçu en fait des rabais ou des avantages au cours de l'année précédente, si les avantages ont compté ou non pour une grande partie du total des recettes du bénéficiaire et si les rabais ont été partagés ou non avec les franchisés, et de quelle manière ils l'ont été, le cas échéant. La Commission recommande aussi une divulgation plus détaillée en ce qui concerne les territoires exclusifs. Lorsqu'un franchisé ne reçoit pas un territoire exclusif en vertu du contrat de franchisage, la Commission recommande qu'une déclaration expresse soit exigée à cet effet.

La Commission a examiné la question de savoir si des catégories supplémentaires de divulgation devaient être incluses pour aider à informer les franchisés sur la nature de la relation à laquelle il faut s'attendre avec les franchiseurs et fournir des informations plus détaillées sur la concession particulière. De l'avis de la Commission, le règlement devrait imposer la divulgation du nombre de poursuites judiciaires intentées par le franchiseur à l'encontre des franchisés et du nombre de différends ayant été réglés par la médiation ou l'arbitrage. De la même manière, les franchisés devraient recevoir de l'information sur le nombre de franchisés actuels ou antérieurs qui font l'objet d'ententes de confidentialité, afin qu'ils puissent évaluer l'étendue et la qualité de l'information qui peut être obtenue en contactant d'autres personnes dans le système de franchise. Un taux de roulement important à un certain emplacement de franchise, ou dans un domaine, peut aussi constituer des renseignements pertinents pour un franchisé éventuel; la Commission recommande que soit divulgué l'historique de la concession qui est offerte et des concessions les plus proches.

Il a été proposé à la Commission que, compte tenu de l'incidence de la relation locateur-locataire sur les affaires commerciales d'une franchise, en particulier avec l'utilisation commune des clauses de manquement réciproque dans les contrats de franchisage et de location, la divulgation devrait être obligatoire lorsqu'une personne physique ou morale liée au franchiseur agit comme sous-locateur des locaux. La Commission accepte cette proposition.

La Commission s'est demandé si les franchiseurs devraient être autorisés à utiliser des documents d'information autorisés en vertu de la loi d'un autre ressort, si des renseignements supplémentaires sont inclus et correspondent à ce qui est nécessaire pour respecter la loi du Manitoba et son règlement d'application. La Commission convient que l'utilisation de ces documents complémentaires serait conforme à l'objectif d'harmonisation entre les provinces et pourrait aider à limiter les coûts supplémentaires que les franchiseurs pourraient devoir assumer pour respecter les exigences du Manitoba. De la même manière, la Commission est persuadée qu'il est approprié de fournir un certain allègement aux franchiseurs en cas d'erreurs ou

d'irrégularités mineures dans un document d'information et recommande que le règlement prévoit qu'un document d'information soit valide s'il respecte de façon substantielle la loi et son règlement d'application.

Actuellement, l'Île-du-Prince-Édouard est la seule administration canadienne qui autorise la remise des documents d'information par voie électronique. La remise par voie électronique correspond à la *Loi sur le commerce et l'information électroniques* du Manitoba et aux pratiques commerciales actuelles et elle peut aider à réduire les coûts d'observation du franchiseur. Toutefois, le franchisé devrait avoir le droit de recevoir les documents sur support papier, au besoin.

La Commission fait plusieurs recommandations en ce qui concerne les cas dans lesquels il devrait y avoir une exemption de l'exigence de divulgation de 14 jours à l'avance. Par exemple, le franchiseur devrait pouvoir conclure une convention de choix de l'emplacement (réserver un lieu de franchise) ou exiger d'un franchisé éventuel qu'il signe une entente de confidentialité en ce qui concerne les renseignements divulgués avant de faire la divulgation. La Commission estime que l'exemption est aussi appropriée pour un dépôt entièrement remboursable, dans des limites d'un maximum, s'il est placé auprès d'un conseiller indépendant.

La Commission s'est demandé s'il fallait prévoir une autorisation, comme dans les autres lois sur le franchisage au Canada, afin que soient pris des règlements exemptant les franchiseurs des dispositions de la loi ou du règlement d'application, en tout ou partie. En Alberta, en Ontario et à l'Île-du-Prince-Édouard, des règlements ont été pris pour exempter les « franchiseurs aux assises solides » de l'exigence qui est faite d'inclure les états financiers dans un document d'information. En règle générale, la Commission n'est pas convaincue que les « franchiseurs aux assises solides » soient à l'abri des difficultés financières ou éthiques et recommande que la *Loi sur le Manitoba* ne prévoie pas d'autorisation en vue de la prise de tels règlements.

Les lois canadiennes sur le franchisage fournissent des recours pour les franchisés lorsque le franchiseur omet de respecter les obligations d'information. Les lois préservent aussi tous les autres droits et recours autrement ouverts aux parties selon le droit. La Commission estime que la loi manitobaine sur le franchisage devrait rester cohérente avec le modèle de projet de loi de la CHLC en ce qui concerne les recours légaux en matière de divulgation et la préservation des droits et recours en common law. Toutefois, la Commission recommande aussi que la loi manitobaine explicite le fait que le recours légal en raison de la présentation inexacte des faits vise les projections et prévisions futures.

La Commission recommande l'uniformité avec les autres lois sur le franchisage en ce qui concerne l'obligation d'agir équitablement et la protection des droits des franchisés de s'associer à d'autres franchisés. D'autres lois sur le franchisage prévoient aussi qu'est nulle la renonciation présumée, par le franchisé, à un droit conféré par la présente loi ou son règlement d'application, ou en vertu de celle-ci ou de celui-ci, ou la libération présumée, par celui-ci, d'une obligation ou d'une exigence imposée au franchiseur par la présente loi ou son règlement d'application. Bien que la Commission soit d'accord avec cette interdiction en principe, à notre avis, il faut distinguer la renonciation à un droit qui est faite avant qu'un différend ne se produise et la renonciation à un droit dans le cadre du règlement d'un différend subséquent. Pour permettre

aux franchisés et aux franchiseurs de régler leurs différends, le Comité recommande que la *Loi* permette aux franchisés de renoncer à un droit ou à une exigence en vertu de la loi ou d'un règlement d'application dans le contexte d'une transaction conclue en règlement.

La législation canadienne sur le franchisage inclut des dispositions limitées visant à réglementer la relation entre les parties à un contrat de franchisage, comme l'obligation d'agir équitablement. Dans certains ressorts, en particulier dans certains États américains et en Australie, la législation impose des restrictions supplémentaires aux conditions que le franchiseur peut inclure dans un contrat, aux changements que le franchiseur peut imposer ou aux mesures qu'il peut prendre. La Commission reconnaît qu'il existe des points de vue différents et bien ancrés dans le milieu de la franchise en ce qui concerne la réglementation de la relation. Toutefois, de l'avis de la Commission, vu le déséquilibre du pouvoir entre les parties qui existe pendant les négociations et qui est inhérent à la relation franchiseur/franchisé, certaines normes doivent être précisées dans la loi. Le cas échéant, les obligations des parties devraient être réciproques. La Commission a fait plusieurs recommandations pour que des dispositions soient incluses dans la loi manitobaine sur le franchisage, en ce qui concerne la relation franchiseur/franchisé, notamment les restrictions à la résiliation d'un contrat de franchisage ou le défaut de renouvellement de celui-ci, l'exigence d'un délai raisonnable pour remédier à toute violation, une disposition permettant à un franchisé d'acheter des produits et services auprès de fournisseurs autres que ceux qui sont désignés par le franchiseur, dans certains cas, et une disposition sur le droit d'intenter une action en dommages-intérêts en raison de la présentation inexacte des faits en cas d'empiètement.

La Commission s'est demandé après réflexion si la loi sur le franchisage du Manitoba devrait prévoir un processus de règlement extrajudiciaire des différends. Elle ne juge pas cette disposition appropriée à ce stade. Elle appuie le recours volontaire à des mécanismes de règlement extrajudiciaire des différends et signale qu'une médiation avant le procès est une pratique courante à la Cour du Banc de la Reine du Manitoba. Lorsqu'un contrat de franchisage contient des stipulations visant le règlement extrajudiciaire des différends, il faudrait exiger une divulgation complète de tous les éléments du processus.

Bien que la Commission soit en faveur du recours à des mécanismes de règlement extrajudiciaire des différends, l'incidence de dispositions obligatoires en matière d'arbitrage sur la possibilité de recours collectifs mérite plus ample examen. Les contrats de franchisage sont habituellement des contrats d'adhésion, et les franchisés ont rarement l'occasion d'influer sur les conditions du contrat et de décider librement de régler tout différend éventuel par voie d'arbitrage. Lorsque des clauses obligatoires en matière d'arbitrage empêchent les recours collectifs, il se peut que, dans les faits, elles refusent l'accès à la justice à des franchisés dont les revendications individuelles ne justifient pas les dépenses d'argent, de temps et d'énergie qu'exige l'arbitrage. De l'avis de la Commission, la loi manitobaine sur le franchisage devrait prévoir une clause d'arbitrage obligatoire dans un contrat de franchisage et que celle-ci soit invalide dans la mesure où elle empêche le franchisé de participer à un recours collectif.

La Commission s'est demandé si un organisme de règlementation en matière de franchise devrait être créé au Manitoba. À notre avis, la création d'un tel organisme serait prématurée et n'est pas recommandée. La Commission recommande effectivement que le gouvernement du

Manitoba mène des initiatives de sensibilisation auprès du public en ce qui concerne le franchisage, y compris la préparation et la distribution de documents didactiques qui expliquent le franchisage et la loi sur le franchisage, et qu'il indique les ressources disponibles pour aider les franchisés éventuels.

La Commission recommande que le gouvernement du Manitoba suive l'exemple de l'Île-du-Prince-Édouard et distribue une ébauche de règlement pour consultation. Elle invite aussi instamment le gouvernement manitobain à travailler avec les gouvernements des autres provinces pour garantir que la législation et la réglementation sur le franchisage soient aussi efficaces et aussi cohérentes que possible, d'un ressort à l'autre, et établir un processus de consultation permanente avec les groupes d'étude.