

**34th Annual IBA/IFA Joint Conference
'A New Era in International Franchising'
8-9 May 2018
JW Marriott in Washington, DC, USA**

**Presented by Peter Dillon
Siskinds LLP
London, Ontario, Canada**



NEWS FROM AROUND THE WORLD

– CANADA –

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1. Canada ranks No. 2 in Best Countries list

Canada continues to be a great country in which to live and work. Its immigration policies have resulted in what, by global standards, might be considered a model of multiculturalism. Its workforce is well-educated, and residents enjoy world-class healthcare. Canada enjoys political stability. Uncertainty regarding the future of the province of Québec within the Confederation has pretty much been forgotten. Its legal system based on the British common law tradition (except for Quebec, which utilizes a Civil Code), is mature and the rule of law is about as solid as can be found in any jurisdiction; the country ranks ahead of the UK, US, Germany and Australia on the Corruption Perceptions Index. Canada consistently ranks in the top few "best countries to live in" surveys.

2. Economic Outlook and Forecast

Canada topped the G7 in 2017 for economic growth (at 3%). The latest International Monetary Fund estimate places Canada at number two for growth in 2018.

Canada enjoys something of a special status given its proximity to the United States, and its favoured trading status with the US, most notably via the North American Free Trade Agreement, the world's largest free trade agreement. Canada is the third-largest direct investor in the US, with over \$450 billion invested in the US economy. 72% of exported Canadian goods are destined for the United States. And it's a two-way street. US companies invested \$388 billion into operations in Canada in 2015 alone. Many believe that President Trump's stated intent to renegotiate NAFTA in a way that benefits his "buy American" initiative is the number one risk for the Canadian economy in 2018.

The Bank of Canada has had a low interest policy since the market crash of 2008. The trendsetting rate was recently increased slightly. Significant changes in the bank's overnight rate, which might act as a brake on economic growth, are not expected in the near term.

Unemployment in Canada fell to a 40 year low in 2017. At the same time, full-time wages rose by almost 3%. These positive numbers are not always good news for franchisors and franchisees looking for relatively low price labour. At the height of the oil boom in Western Canada, our firm was engaged by more than one large franchise system to assist in gaining temporary visas for Mexican workers to staff fast food outlets, since franchisees could not compete with the wages being paid in the oil patch.

3. Currency

Currency fluctuations may have a significant impact on Canadian operators of foreign systems. Franchise systems that require the purchase of products or even services from a foreign jurisdiction may end up rendering the franchisee relatively uncompetitive by virtue of increased product costs. Clearly, if a foreign franchisor merely converts its franchise fee into Canadian dollars, it may result in significantly higher costs for the Canadian operator. This is true both in respect of euro and US dollar denominated systems, given the decline in value of the Canadian dollar over the last few years.

When it comes to royalties, systems that are based on a percentage of sales tend to carry that percentage from one jurisdiction into the next. This places the FX risk on the franchisor.

If a franchisor operates a branch in Canada (as opposed to via a subsidiary corporation), then royalty payments to the foreign-based franchisor will be subject to a withholding tax of 25% (reduced to 10% to 15% in the case of jurisdictions with whom a tax treaty has been negotiated). Since the franchisor in most cases should receive a foreign tax credit in respect of the withholding, this is generally a tax neutral event, although in most cases, the franchisor will not be made completely whole.

4. Labour and Employment

Ontario, a province accounting for 40% of Canada's GDP and population, introduced sweeping changes to its employment laws in 2017, by way of the *Fair Workplaces, Better Jobs Act, 2017*.

Minimum Wage Increase

As of January 1, 2018 the minimum wage in Ontario jumped to \$14, a 20% increase from the previous minimum of \$11.60. The hike had a significant effect on franchised businesses.

Changes to Paid Vacation and Holiday Pay

Employees who have been with their employer for at least 5 years are now entitled to 3 weeks of vacation, up from 2 weeks. Employees with less than 5 years of seniority still receive a minimum of 2 weeks.

Notice for Temporary Workers

When on an assignment scheduled to last more than 3 months, temporary workers must be given at least 1 weeks' notice if the assignment ends early. If employees do not receive adequate notice, they are entitled to pay in lieu of notice.

New Scheduling Rules

Employees now have the right to request changes to their schedule or location after 3 months of employment without fear of retribution. Employees may refuse shifts without fear of repercussions, if shifts are assigned with less than 96 hours' notice, and employers must keep records of the dates and times employees are scheduled to work, as well as any schedule changes.

Minimum 3 Hours of Pay

If an employee regularly works more than 3 hours per day, but shows up for work and receives less than 3 hours of work, they must now be paid for at least 3 hours. Similar rules apply for shifts cancelled with less than 48 hours' notice. Employers must also pay all on-call workers for at least 3 hours of work for every 24 hour period they're required to be on-call, regardless of whether they actually work.

"Sick Notes" Banned

Employers are no longer permitted to ask for a doctor's note when employees call in sick.

More Personal Leave

All companies must now offer paid personal emergency leave. Previously, only companies with more than 50 employees had to do so. Workers are entitled to 10 personal emergency days per

year, the first 2 of which must be paid. Employees are also entitled to new or increased leaves related to a sexual or domestic assault, family medical issues, pregnancy leave following miscarriage or stillbirth, and a child's death or disappearance, among others.

Equal Pay For Equal Work

Contract, temporary, seasonal and part-time workers are now entitled to the same pay rate as full-time workers if they perform "substantially similar" work. Workers may now request a review of their pay, if they suspect they're being underpaid compared to similar employees. Employers are prohibited from reducing the higher paid employee's pay rate in an effort to equalize wages.

5. Legislative Developments

British Columbia's Franchise Act

You likely are aware from last year's Update that British Columbia's franchise law came into force on February 1, 2017, making it Canada's sixth province to mandate presale disclosure.

PIPEDA

As of November 1, 2018, Canadian businesses that have a privacy breach must give notice of the breach under the *Personal Information Protection and Electronic Documents Act* (PIPEDA) – the privacy legislation affecting the private sector in most Canadian provinces. Reporting must occur if there is a privacy breach that "creates a real risk of significant harm to an individual". That includes bodily harm, humiliation, damage to reputation, financial loss, and identity theft. The report must be made "as soon as feasible after the organization determines that the breach has occurred." Circumstances of the breach, when it happened, what information was breached, steps taken to reduce the risk of harm, steps individuals can take to reduce risk, and contact information of the company must be included in the report. Reports must be filed with the Canadian Privacy Commissioner, the individuals, and third parties that "may be able to reduce the risk of harm." One of the most challenging aspects of the reporting obligation is a requirement to maintain a "record of every breach of security safeguards involving personal information under its control." The record must be shown to the Privacy Commissioner on request. The challenge is that there is no stated threshold, and every breach, even trivial ones, must be recorded. A failure to report when required, and failure to keep the breach records, may result in a penalties of up to \$100,000.

CASL

The Canadian federal government has announced that it has suspended the coming into force of the private right of action under Canada's anti-spam legislation (CASL), originally scheduled to come into force on July 1, 2017.

Under the private right of action, organizations (as well as their officers, directors and agents) could be sued by anyone claiming to have been "affected" by an act or omission that violated CASL. Plaintiffs could claim both compensatory damages (for any actual losses or damages they may have suffered) as well as statutory damages, which in some circumstances could be up to \$1 million per day, even where no actual harm was proven.

The government's announcement does not indicate if or when the private right of action may take effect in the future.

Amendments to Ontario's Franchise Law

In October 2017 Ontario introduced amendments that clarify that only the agreement by which the franchise is actually granted (and not merely a deposit, confidentiality or other ancillary agreement) triggers a disclosure obligation on the part of the franchisor (and a potential rescission remedy for the benefit of the franchisee). The proposed amendments will allow franchisors to enter into confidentiality, non-disclosure and location agreements with prospective franchisees and to accept fully refundable deposits that do not exceed a prescribed amount (20% of the initial franchise fee), without triggering the disclosure obligation.

The amendments also include clarifications regarding disclosure exemptions, including the "large investment" (in excess of \$5M) and "fractional franchise" (less than 20%) exemptions.

6. In the Courts—*Raibex*

Ontario's Court of Appeal released its much-anticipated decision in *Raibex* on January 25, 2018. I say much-anticipated because the summary judgement decision of Justice Wendy M. Matheson of the Superior Court of Justice had thrown the proverbial wrench into the works of most franchisors.

Distilled version of the facts

The franchise prospect received a disclosure package that was delivered as a single document, at one time, in a timely fashion (at least 14 days prior to executing the franchise agreement or receiving any payment). The disclosure document:

- did not specify a location for the prospective franchisee's restaurant;
- included a draft sublease, which indicated that the franchisee was obliged to accept all terms in the head lease negotiated by the franchisor and the landlord of the proposed restaurant;
- did not contain a draft of that head lease;
- provided an estimate of development costs to develop the restaurant from a shell;
- indicated that the cost to convert a pre-existing restaurant to a branded restaurant was highly site-specific, although in the franchisor's experience, these costs had been significantly lower than the cost of building from a shell;
- cautioned that significant cost overruns could occur during a conversion due to infrastructure deficiencies that remain undetectable until reconstruction commences;
- stated that the franchisor had no reasonable means of estimating or predicting conversion costs with any certainty; and,
- recommended that the franchisee maintain a "significant contingency reserve."

The franchise agreement did not specify a site for the prospective restaurant, nor a territory. The territory was to be “reasonably determined by the franchisor.” The agreement required the parties to “use their reasonable best efforts to find a suitable location for the [restaurant] acceptable to the franchisor.”

The franchise agreement also provided that if the franchisor failed to negotiate a lease for a suitable location within 120 days of the agreement being signed, the franchisee was entitled to terminate the agreement upon 20 days’ notice and receive a release and refund of all amounts paid to the franchisor, less any costs and expenses reasonably incurred by the franchisor in connection with the granting of the franchise.

Following execution of the franchise agreement, the franchisor and franchisee located a mutually acceptable location in Mississauga, Ontario available for lease and conversion. The franchisor’s affiliate signed the head lease and sublet the property to the franchisee. The head lease required a steep initial deposit of approximately \$120,000.

Prior to signing the sublease, the franchisee had been informed of the hefty deposit requirement but had not received a copy of the executed head lease. The franchisee consented to the deposit condition and asked the franchisor to “please accept [the lease], we want this deal to be done ASAP.”

Construction of the restaurant was substantially completed at a cost exceeding \$1 million. This amount fell within the range specified in the disclosure document for construction from a shell. However, this location had been developed through conversion and as noted, no cost range had been provided in the disclosure document for the development of a conversion location.

Upon completion of construction, the franchisor asked the franchisee to pay a variety of unpaid construction invoices and the \$120,000 deposit required under the head lease. The franchisee refused and served a notice of rescission. The franchisor refused to accept the notice of rescission, terminated the franchise agreement, and assumed control of the outlet.

Decision of the motion judge

The motion judge declared that the franchise agreement had been validly rescinded and awarded damages in favour of the franchisee in an amount of Can\$1.28 million.

She found that the disclosure document did not contain “all material facts” as required by section 5(4) of the Arthur Wishart Act, for two reasons. First, the disclosure document did not include the terms of the head lease by which the franchisee would be bound. Second, although the disclosure document outlined the estimated costs for developing the restaurant from a “shell,” it did not provide cost estimates for converting an existing restaurant to its own brand.

In the motion judge’s view, the franchisor could not be excused from its obligation to disclose these facts simply because they were not known to both parties when the franchise agreement was signed. She stated, “until the franchisor is prepared to make proper disclosure of all material facts, it must wait — it does not get excused from its statutory obligations.”

To hold otherwise, in her view, would allow franchisors to make disclosure at a premature stage and avoid the Act’s rigorous disclosure requirements, undermining the purpose of the legislation. She held that the franchisor’s breach of its disclosure obligations was “egregious” and contained

“stark and material deficiencies” with respect to the franchisee’s lease obligations and estimated development costs.

Implications of the summary judgment decision

The practical implications of the summary judgment decision were enormous and negative to franchisors (and, I would argue, to franchising generally — including franchisees). Many systems operate on the basis that the documentation will be signed, whereupon the parties set out to find a mutually agreeable location. To prevent this from happening would be a huge impediment to the growth of most systems.

It also places an unfair burden on franchisors, who typically complete the franchise sales process and then engage in lease negotiations, without the fear of being “left at the altar” by a prospect who develops cold feet, leaving the franchisor holding a lease and location, with no franchisee to operate it. Finally, it amounted to a judicial imposition of terms that simply do not exist anywhere in the Act. There is nothing that prohibits using a form of “generic” disclosure, with the parties then mutually agreeing on location and other development decisions (note, however, that this decision does not relieve franchisors from the obligation to provide “site-specific” disclosure in accordance with the requirements of this decision.

The Court of Appeal weighs in

The franchisor argued that the decision of the motion court judge was unsupported by authority, inconsistent with the text of the Act, and was commercially unreasonable. The Court of Appeal agreed.

The court started its analysis by distinguishing between section 6(1), which provides for disclosure within 60 days of late or deficient disclosure, which must occur within 60 days of receipt of the disclosure document, and a rescission in accordance with subsection 6(2), where the franchisor never provides disclosure, which must occur within two years after entering into the franchise agreement. The court cited a prior decision in support of the proposition that the right of rescission under subsection 6(2) was an “extraordinary remedy.”

In this case, of course, the franchisor had provided a disclosure document. In such circumstances, for a franchisee to succeed with his rescission claim, the purported disclosure document must be so deficient as to effectively amount to a complete lack of disclosure. As the court previously stated in this case: “a document does not become a disclosure document ... just because it is called a disclosure document.”

Whether deficiencies in the disclosure document were so serious as to amount to no disclosure for purposes of the Act must be determined on the facts of each case. The court referenced several of its prior decisions in which it described the required degree of deficiency in several ways, including “materially deficient,” “serious noncompliance,” “fundamentally inadequate and deficient disclosure,” and “stark and material deficiencies.” Whatever terminology is employed, the court found that the inquiry into whether disclosure deficiencies are such that they justify rescission ultimately focuses on whether the franchisee has been “effectively deprived ... of the opportunity to make an informed [investment] decision,” as cited in this case.

Dealing with the issue of the failing to include a copy of the head lease as part of the disclosure document, the Court of Appeal found that the motion judge's failure to consider the terms of the franchise agreement entered into between the parties constituted "an inextricable error of law."

In this case, all parties involved knew that the proposed restaurant location had not been selected, and agreed that the franchisor and the franchisee would work collaboratively to select the site. These provisions were incorporated into the franchise agreement in a variety of locations. The franchise agreement contemplated the active participation of the franchisee in the selection of the location and provided the franchisee with an opt-out right in the event that they did not favour the proposed site or found any provision of the head lease to be unacceptable.

In the circumstances where the franchisee had these contractual protections, the absence of the head lease information at the time of entering into the franchise agreement "had little impact on the franchisee's ability to make an informed investment decision." As noted, the franchisee participated actively in the site selection and was aware of the quantum of the rent deposit upon which he later sought to base his rescission claim. In those circumstances, the court found that he did not have a valid basis to rescind.

With respect to the conversion cost estimates, the court found that the lengthy and detailed provisions in the disclosure document ought to have put the prospect on notice as to the potential risks associated with pursuing a conversion opportunity by providing:

- cost estimates for developing a branded restaurant;
- a strongly worded warning that the cost estimates associated with a conversion could vary greatly from site to site; and
- a warning to the franchisee to maintain a significant contingency reserve.

For these reasons, the Court of Appeal found that the motion judge's conclusion that the disclosure document amounted to "no disclosure at all" could not be supported.

The court concluded by awarding the costs of the trial and of the appeal to the franchisor — damages in the amount of \$110,000 representing unpaid construction invoices, and payment of the rent deposit of \$119,000, adjusted for any financial benefit the franchisor derived from operating in the restaurant for the duration of the lease.

Key takeaways and best practices

Decisions of the Court of Appeal that are favourable to franchisors are relatively few. While the recent decision represents a definite "win" for commercial reasonableness and a measured interpretation of the Act, its limitations should be borne in mind by franchisors and their counsel.

First, the case does stand for the proposition that "premature disclosure" by itself does not exist as a prohibited practice under the Act. This means that signing a franchise agreement or accepting payments after making compliant disclosure — i.e. disclosure based on what the franchisor knows at the time of disclosure — is OK.

Second, don't lose sight of the fact that the decision does not affect the extremely onerous obligation of site-specific disclosure created by the Court of Appeal in this decision.

Third, the decision does not in any way limit the requirement to disclose “all material facts.” The risks of that open-ended regime still exist.

Fourth, and on a similar note, this decision was based upon the two-year right of rescission under subsection 6(2) of the Act. The court expressly stated that the results might have been different had the rescission claim been brought within 60 days of disclosure, based on “deficient disclosure” under ss. 6(1).

Fifth, personal liability of signatories to disclosure documents remains, underlining the extreme care that must be devoted to compliance with the franchisor’s disclosure obligations.

Sixth, franchisors and their counsel should undertake a close review of their franchise agreement to ensure that strong and clear contractual terms exist with respect to any circumstances about which full disclosure at the time of signing the franchise agreement — such as site selection — cannot be made. Strong wording of the franchise agreement in the recent case likely saved the day for the franchisor.

Seventh, strong and clear risk warnings in the franchisor’s disclosure document dealing with situations — such as site development — where risk exists and precise numbers can’t be provided, are essential.

Eighth, the court did not decide the issue of whether signature of the certificate of disclosure by the franchisor only — and not by individual officers or directors — was compliant. Best practice may therefore dictate that certificates of disclosure be signed by the signatories in their individual capacities. The signatories need to be reminded of their personal liability should the franchisor be unable to satisfy the full amount of a rescission claim.

And so, celebrations should likely be limited to a good bottle of prosecco. Save the champagne for now.

7. Status of Franchising Generally

Franchising in Canada falls within the constitutional authority of the provinces and hence there is no federal legislation in the area. On the upside, the six provinces that have introduced franchise legislation have adopted a substantially similar format. The downside is that, to the extent the adopted format is faulty, the faults extends to all Canadian jurisdictions.

Despite all of the very positive factors and trends enumerated above, and at the risk of ending on a sour note, it must be stated that Canada remains a challenging jurisdiction in which to operate by way of a franchise model.

This is not because of the presale disclosure requirements *per se*, but rather because of some of the peculiar aspects of the legislation, and the sometimes surprising manner in which the laws have been interpreted and applied by the courts. Specifically:

Expansive Personal Liability

Personal liability arises in all Canadian jurisdictions if a franchisee suffers a loss because of a misrepresentation contained in the disclosure document or in a statement of material change, or as a result of the franchisor’s failure to otherwise comply with its disclosure obligations. Parties

potentially facing personal liability include the franchisor (if he or she is an individual), the franchisor's agent, the franchisor's broker, the franchisor's associates, and every person who signed the disclosure document or statement of material change. Each of the six Canadian statutes requires that two officers or directors of the franchisor sign the disclosure document, certifying that the disclosure document contains no untrue information, representation, or statement, and that it includes every material fact, financial statement, statement, or other information required to be included.

All Material Facts

Canadian franchise disclosure laws require that two categories of information be disclosed to a franchise prospect. First, franchisors must disclose all specified information prescribed by regulation. This is a "closed" list of facts similar to the twenty-three prescribed Items of disclosure found in the FTC Franchise Rule.

The second category of information that franchisors must disclose is an "open-ended" requirement that the disclosure document contain "all material facts, including material facts as prescribed."

In light of the breadth of this definition, the list of what might constitute a material fact is limitless. Although the definition requires that the information have "a significant effect on the value or price of the franchise . . . or the decision to acquire the franchise," there is no requirement that the value be negatively affected. Based on the definition, even a material fact that might have a significant positive effect on the value or price of the franchise must be disclosed.

Site-Specific Disclosure

The Court of Appeal of Ontario in *6792341 Canada Inc. v. Dollar It Limited* held that a generic form of disclosure document was not adequate to allow a prospect to make an "informed" decision regarding a proposed purchase of a franchise. In particular, the court found that the disclosure document lacked information regarding the specific territory to be granted, as well as a copy of the head lease for that particular property.

The advent of site-specific disclosure obligations has exponentially increased the time and energy expended by franchisors and their counsel to provide compliant disclosure and has resulted in a concomitant increase in the risk of failing to do so. The idea that one can hand out a "one size fits all" disclosure document, and then proceed with the business of finalizing the terms of the franchise agreement and development of the location, must be completely discarded.

What Constitutes a Loss and Accounting for Profits

In the *Springdale Pizza* series of cases, the franchisor sought to reduce the amount it had to pay to a franchisee for supplies and equipment on a rescission claim under Section 6(6) of the Ontario Act. The franchisor claimed that the equipment was in very poor condition and that the franchisee was therefore "unable" to return the equipment. The Master found that because the Ontario Act is intended to be remedial, the franchisee had no duty to mitigate, and the franchisor's obligation to repurchase the equipment existed regardless of its condition.

The rescinding franchisee had earned a small net profit during the period of operation prior to rescission. The court was asked to determine whether the net profits of the franchisee should be set off against the losses for which the franchisee was to be compensated, or whether the franchisee was simply entitled to no compensation. The court concluded that the Ontario Act does not provide for a franchisor to set off any revenue against other amounts awarded. And so, at least in Ontario, a rescinding franchisee may end up better off than he would otherwise have been had he never purchased the franchise.

Skewed Norms of Judicial Interpretation

Canadian courts have adopted a “purposive” approach to the interpretation of franchise disclosure legislation. The purpose of franchise disclosure laws, according to most decided cases, is to protect franchisees. The purposive approach was first enunciated by the court in *Personal Services Coffee Corp. v. Beer*:

It is clear, therefore, that the focus of the Act is on protecting the interests of franchisees. The mechanism for doing so is the imposition of rigorous disclosure requirements and strict penalties for non-compliance. For that reason, any suggestion that these disclosure requirements or the penalties imposed for non-disclosure should be narrowly construed, must be met with skepticism.

The ambit of the purposive approach was widened by the Court of Appeal in the case of *Salah v. Timothy's Coffees of the World, Inc.*, when the court stated:

The Wishart Act is sui generis remedial legislation. It deserves a broad and generous interpretation. The purpose of the statute is clear: it is intended to redress the imbalance of power as between franchisor and franchisee; it is also intended to provide a remedy for abuses stemming from this imbalance.

The result of this purposive approach has been, in the author's opinion, a highly technical interpretation and application of the legislation that has substantially increased the risk and liability to franchisors operating in the Canadian market.

8. Conclusion

Canada continues to be an extremely attractive market for franchisors undertaking international expansion. The combination of many factors, including economic, educational, and demographic, should continue to maintain Canada high on the list of overseas markets.

That said, franchisors and their advisors are cautioned that proven risk factors exist that mandate that expansion into Canada should be undertaken only with the benefit of close guidance and ongoing supervision from experienced Canadian franchise counsel.