Chapter 16

CANADA

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I INTRODUCTION

For over 50 years, American and other foreign franchise systems have designated Canada as a country of choice for their international expansion. Canada presents a host of advantages including language and culture as well as geographic proximity, in particular for American systems, similarity of law, a business environment that is 'franchise-friendly' as well as a legal environment often less complex than in other jurisdictions. Canada presents many other advantages such as a well-educated and skilled workforce, average disposable income on par with American consumers and the availability of affordable commercial real estate. In addition, Canada is renowned for its abundant natural resources, effective transportation infrastructure and state-of-the-art telecommunications. Finally, Canada is a vast and arguably a highly developed country where opportunities for investment are plentiful and where success stories abound.

International franchisors occupy a significant position in the Canadian franchise landscape including well-known American systems such as McDonald's, KFC and Burger King, just to name a few in the fast food restaurant industry. However, domestic franchisors, both large and small, such as Tim Hortons or Sports Experts, constitute the majority. Moreover, franchise systems in other industry sectors such as real estate brokerage services and retail have also thrived, despite the sometimes challenging economic swings. Franchising is thus a robust and growing business model in Canada.

In Canada, the franchise community is represented by the Canadian Franchise Association (CFA), which acts as the national voice of franchising in Canada. The CFA has over 600 corporate members committed to the growth, enhancement and development of franchising, and aims to work with industry members including

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governments to develop industry-made solutions, promote excellence in franchising and educate Canadians about franchising.[2]

II MARKET ENTRY

i Restrictions

For foreign franchisors, Canada presents no particular restrictions or barriers to carrying on business other than having to comply with Canadian legislation and, in particular, the franchise legislation enacted in five Canadian Provinces (Alberta, Ontario, New Brunswick, Prince Edward Island and Manitoba). In addition, other than the requirement to comply with applicable legislation, there are no particular restrictions regarding the granting of master franchise or development rights to local Canadian-based entities.

Non-Canadian investors commencing a new business in Canada or acquiring control over an existing Canadian business must notify Industry Canada within 30 days of the transaction. For acquisitions, certain thresholds have been established to determine whether a transaction has to be reviewed. Acquisitions below these thresholds are generally not subject to review. As for the ownership of real estate by foreign nationals, Canada has an open-door policy and thus, there are no restrictions regarding the investment in real estate save for certain circumstances, such as agricultural land.

III INTELLECTUAL PROPERTY

In Canada, trademarks and unfair competition are governed by both federal and provincial legislation, as well as common law (or civil law in the province of Quebec) to protect acquired or registered rights.

i Brand search

Prior to filing an application for the registration of a trademark, franchisors should (although they are not required to) conduct searches to determine the availability of the trademark and its possible registration. These searches involve the consultation of the records of the Canadian Intellectual Property Office (CIPO) and can easily be performed online.[3] Other searches may include those in trade directories, telephone directories, corporate name directories and generally, on the internet. All of these searches, including the records of the CIPO, should not be considered definitively conclusive but they can provide a fair indication as to the registration potential of a proposed trademark.

ii Brand protection

Once searches have been conducted and a proposed trademark has been identified for registration purposes, an application must be filed with the CIPO and a trademark examiner will review the application to determine whether the proposed trademark meets

2 CFA website: www.cfa.ca/About_us/.

3 www.ic.gc.ca/eng/goc/cipo.shtml.

the requirements of the Trademarks Act[4] and whether it can be registered (the process may take several months), in which case the proposed trademark may be approved for publications in the Trademarks Journal. If the proposed trademark is not approved, the applicant will be advised and may amend its application or submit arguments for consideration by the examiner. Where an application is refused, the applicant may apply to the courts to contest the decision of the examiner. It should be mentioned that failure to respond to the examiner may be deemed an automatic abandonment of the application.

Once the proposed mark is published in the Trademarks Journal, within two months of such publication, any interested party may file a statement of opposition with the Registrar of Trademarks stating the grounds for opposition. If the opposition is considered to raise substantial issues for consideration, the applicant is then offered an opportunity to respond and the Registrar may then refuse the application or reject the opposition. Either party may subsequently apply to the courts to contest the decision of the Registrar.

iii Enforcement

Pursuant to the Trademarks Act, a person not entitled to use a registered trademark who sells, distributes or advertises wares or services in association with a confusing trademark or trade name shall be deemed to be infringing upon the right of the owner of a registered trademark. The Federal Court of Canada has jurisdiction over the enforcement of the provisions of the Trademarks Act. The enforcement by the owner of a registered trademark may be made under the Trademarks Act but also under common law. The tort of 'passing-off' aims to prevent a party from copying not a name but the look of a particular business, which is often referred to as 'trade dress' or 'get-up'. In the province of Quebec, an action in passing-off would be based on the provisions of the Civil Code of Quebec.[5]

iv Data protection

The Personal Information Protection and Electronic Documents Act (PIPEDA)[6] came into force on 1 January 2001 and aims to set ground rules for the management of personal information in the private sector. It further aims to balance an individual's right

4 Trademarks Act, R.S.C., 1985, c. T-13.

5 Article 1457 C.C.Q. stipulates that:

Every person has a duty to abide by the rules of conduct which lie upon him, according to the circumstances, usage or law, so as not to cause injury to another. Where he is endowed with reason and fails in his duty, he is responsible for any injury he causes to another person by such fault and is liable to reparation for the injury, whether it be bodily, moral or material in nature. He is also liable, in certain cases, to reparation for injury caused to another by the act or fault of another person or by the act of things in his custody.

6 S.C. 2000, c. 5.

to the privacy of personal information with the need of organisations to collect, use or disclose personal information for legitimate business purposes.[7]

Organisations covered by PIPEDA must obtain an individual's consent when they collect, use or disclose the individual's personal information. The individual has a right to access personal information held by an organisation and to challenge its accuracy. Personal information can only be used for the purposes for which it was collected. If an organisation wishes to use the information for another purpose, consent must be obtained again. Individuals should also be assured that their information will be protected by specific safeguards, including measures such as locked cabinets, computer passwords or encryption.

An individual may complain to the organisation in question or to the Office of the Privacy Commissioner of Canada about any alleged breaches of the law. The Commissioner may also initiate a complaint, if there are reasonable grounds. It is an offence to destroy personal information that an individual has requested, to retaliate against an employee who has complained to the Commissioner or refuses to comply with Sections 5 to 10 of PIPEDA, or to obstruct a complaint investigation or an audit by the Commissioner or her delegate.

PIPEDA does not cover the collection, use or disclosure of personal information by federal governmental organisations listed under the Privacy Act, provincial or territorial governments and their agents, an employee's name, title, business address or telephone number, an individual's collection, use or disclosure of personal information strictly for personal purposes (e.g., personal greeting card list), an organisation's collection, use or disclosure of personal information solely for journalistic, artistic or literary purposes, and finally, employee information, except in federally regulated sectors. Finally, some provinces, such as Quebec, have enacted their own legislation relating to privacy, which should also be examined.

IV FRANCHISE LAW

i Overview of legislation

In Canada, the Constitution Act 1867[8] imparts exclusive jurisdiction over certain areas to the federal government or the provinces. Consequently, where trade and commerce, banking and bills of exchange, bankruptcy and insolvency, intellectual property including trademarks, patents and copyrights, and competition (antitrust), for example, are the exclusive jurisdiction of the federal government,[9] property and civil rights, contracts and the administration of justice[10] are the exclusive jurisdiction of the provinces. As a result, franchising falls within the jurisdiction of the provinces, although some aspects (notably trademarks and competition) will be subject to federal scrutiny.

7 Office of the Privacy Commission of Canada, www.priv.gc.ca./information.

8 (U.K.), 30 & 31 Vict., c. 3, reprinted in R.C.S. 1985, App. II, No. 5.

9 Ibid., S-91.

10 Ibid., S-92.

To date, five Canadian provinces have enacted franchise legislation. They are, in chronological order: Alberta,[11] Ontario,[12] Prince Edward Island,[13] New Brunswick[14] and Manitoba.[15] The main features of each of these five franchise laws are pre-sale disclosure, the duty of fair dealing, the right to associate and relationship provisions. A sixth province, British Columbia, is currently contemplating franchise legislation and the British Columbia Law Reform Commission has recommended that franchise legislation be implemented in that province. It is expected that some of the remaining Canadian common law provinces (Saskatchewan, Nova Scotia and Newfoundland and Labrador) may eventually follow suit and enact their own similar provincial legislation. As for the only civil law province, Quebec, it is unlikely that it will adopt any form of franchise legislation in the near future.

The absence of franchise legislation in the remaining five provinces that do not have legislation essentially means that franchisors are not obligated to disclose information or bear the delays of a 'cooling-off' period prior to executing franchise agreements. However, if a franchisor is a member of the CFA, it is subject to its Code of Ethics, where a mandatory disclosure policy requires 'full and accurate written disclosure of all material facts' related to its franchise at least 14 days before a 'binding agreement relating to the award of the franchise' is executed. In the province of Quebec, members of the Quebec Franchise Council are encouraged to disclose, in advance, to potential franchisees all material facts and important information before executing any document related to a franchise.

ii Specific legislation

Ontario

The province of Ontario enacted the Arthur Wishart Act[16] (the Wishart Act) in 2000 with an effective date of 31 January 2001. The Wishart Act was designed to protect the purchase of franchises in an attempt to level the playing field between franchisors and franchisees. The Wishart Act applies to all prospective franchisees wholly or partly operated in Ontario and therefore applies, for example, to a prospective franchisee located in Alberta who plans to operate in Ontario. Franchisors are required to provide a disclosure document to prospective franchisees containing all 'material facts' prescribed in the regulations, as well as the financial statements of the franchisor, copies of all agreements that the franchisee will be required to sign, certain mandatory statements and other information stipulated in the regulations.

In order to be subject to the Wishart Act, franchisors must fall within the definition of a 'franchise', which is very broad and may cover many arrangements. The key elements of the definition of a franchise are: the right to engage in a business, the

11 RSA 2000, c. F-23.
12 SO 2000 c. 3.
13 RSPEI 1988, c. S-14.1.
14 SNB 2007, c. S-23.5.
15 CCSM c. S-156.
16 *Supra*, footnote 12.

association with a franchisor's trademarks, the exercise, by the franchisor, of significant control over or assistance in the franchisee's business and initial or continuing payments to the franchisor. In addition, the Wishart Act imposes on each party to the franchise agreement a duty of fair dealing in its performance and enforcement.[17] The duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.[18] The duty may also affect the exercise of a franchisor's discretion in the application of the provisions of a franchise agreement. Finally, the Wishart Act gives franchisees the right to sue for breach.

Another feature of the Wishart Act relates to the right to associate. A franchisee may associate with other franchisees and may form or join an organisation of franchisees.[19] The Wishart Act also stipulates that a franchisor and a franchisor's associate may not interfere with, prohibit or restrict, by contract or otherwise, a franchisee from forming or joining an organisation of franchisees or from associating with other franchisees.[20] Finally, the Wishart Act stipulates that a franchisor and a franchisor associate may not, directly or indirectly, penalise, attempt to penalise or threaten to penalise a franchisee for exercising any right under this section.[21]

Of particular importance to foreign franchisors wishing to expand into Canada is the fact that the provisions of the Wishart Act cannot be excluded in a franchise agreement where there is a claim under the Act. It signifies that parties to the franchise agreement cannot contract out of, or waive rights or obligations that stem from, the Wishart Act.

Under the Wishart Act, all material facts must be disclosed. Material facts include any information about the business, operations, capital or control of the franchisor or franchisor associate, or about the franchise system, that would be reasonably expected to have a significant effect on the value or the price of the franchise to be granted or the decision to acquire the franchise. Of note is the definition of the franchisor's associate, which means a person who, directly or indirectly, controls or is controlled by the franchisor, or, is controlled by another person who also controls, directly or indirectly, the franchisor and who is directly involved in the grant of the franchise. The granting of a franchise includes being involved in reviewing or approving the grant of the franchise or by making representations to the prospective franchisee on behalf of the franchisor for the purpose of granting the franchise or offering to grant the franchisor or exercising operational control over the franchise and to whom the franchisee has a continuing financial obligation. Franchisor's associates include parent companies, principal shareholders, employees and franchise salespersons.

All information must be set out accurately, clearly and precisely. For further information regarding all material facts to be disclosed, we refer to the Wishart Act

17 Ibid., Section 3(1).

18 Ibid., Section 3(3).

19 Ibid., Section 4(1).

20 Ibid., Section 4(2).

21 Ibid., Section 4(3).

Regulations.[22] Some of these facts include the business background of the franchisor, including the name, jurisdiction, history of involvement in a franchise and franchise sales, the business background of the franchisor's principals, litigation and bankruptcy matters, leasing relationships, purchasing requirements, statutory disclosure and warning statements, the cost disclosure, including fees, deposits, construction and ongoing expenses, the financial performance and representations (although this is voluntary), financing programmes, training programmes and other assistance summaries, historic use of collective advertising fund monies, restrictions and requirements imposed by the franchise agreement, volume rebate policies, the franchisor's rights to trademarks, licences and permits required to operate, territory descriptions and proximity policies, franchise locations and operator lists, term and renewal summary, financial statements or opening balance sheets, certificates, etc. Other material facts may include facts that are unique to the situation and are on a case-by-case basis.

In Ontario, the complete franchise disclosure document must be delivered at one time by personal delivery or by registered mail. E-mail is not yet accepted. Also, the franchise disclosure document must be delivered to the prospective franchisee not less than 14 days before the earlier of the signing of any agreement or the taking of any money. No deposits, confidentiality or other agreements can be signed in advance of such disclosure.

The Wishart Act provides for certain exemptions from having to provide a disclosure document, including the transfer by a franchisee for its own account in the absence of any franchisor involvement, the grant of a franchise to an officer or director having at least six months' employment with the franchisor, the grant of additional franchises to the same franchisee if no material change has occurred, the sale by a trustee or a receiver and the sale of a fractional franchise (less than 20 per cent). In addition, parties are exempt from disclosing upon the renewal or extension of a franchise if no material change and no new agreement is signed.

The complete failure to disclose may give rise to a right of rescission by the franchisee within two years of signing the franchise agreement. Improper or incomplete disclosure will give rise to the franchisor's right to rescind within 60 days following the receipt of the disclosure document if not provided in time or if a material change statement is not provided or is deficient. In any case, a claim can include a refund of monies paid, equipment and inventory purchased, as well as compensation for losses incurred. Case law pertaining to the absence of the required disclosure reveals that the absence of financial statements in a franchise disclosure documents is tantamount to the absence of disclosure and gives rise to a two-year right of rescission. Franchise disclosure documents with significant omissions have also given rise to two-year rights of rescission. Finally, if a franchisee suffers losses due to misrepresentation, it is entitled to sue for damages.

Franchise disclosure documents must be revised and updated on a constant basis in order to incorporate any material changes such as those that would reasonably be expected to have a significant adverse effect on the value or the price of the franchise

22 O Reg 581/00.

to be granted or on the decision to acquire the franchise. In the event of a material change, notice must be given to the prospective franchisee by way of a statement of material change as soon as such change happens and before signing or accepting any consideration. Obligation to give notice will extend up to the signing of a franchise agreement.

Alberta

Alberta was actually the first Canadian province to enact franchise legislation in 1972. In 1995, a new Alberta Franchises Act[23] was enacted. The statute requires pre-sale disclosure by way of a mandatory disclosure document, which must be received by a prospective franchisee at least 14 days before the prospective franchisee signs a franchise agreement. The disclosure document must comply with regulations requiring that it contain all material facts. The material facts to be disclosed are very similar to those contained in the Wishart Act. The disclosure document must also contain copies of the proposed franchise agreement, financial statements and reports and other documents required by the regulations.

The most distinguishing feature of the Alberta Franchises Act, unlike in the other Canadian provinces, is the residency requirement for franchisees. As a result, in order for the Alberta Franchises Act to apply to a particular franchise, not only must the franchise be operated in Alberta, but the franchisee must also be an Alberta resident.

Prince Edward Island

Prince Edward Island's Franchise Act[24] is almost identical to the Wishart Act.

New Brunswick

The province of New Brunswick enacted its Franchisees Act (the New Brunswick Act)[25] in 2007, and it came into force in 2011. The provisions of the New Brunswick Act are quite similar to those of the Wishart Act in Ontario. Unlike the Wishart Art, the New Brunswick Act specifically states that a confidentiality agreement does not qualify as a 'franchise agreement' for the purposes of the 14-day 'cooling-off' period. As a result, franchisors have the ability to execute confidentiality agreements with prospective franchisees within this period.

Another unique and distinguishing feature of the New Brunswick Act is the dispute resolution process. The New Brunswick Act stipulates that, in the event of a dispute, one party may notify the other of the nature of the dispute and the desired outcome. If such a notice is delivered, the parties must attempt to resolve the dispute within 15 days of receiving the notice. If the parties are unable to resolve the dispute, a notice to mediate may be delivered, and upon delivery of such notice, the parties must follow the rules relating to mediation. The mediation regulation allows a party receiving a notice to decline mediation by providing a notice to that effect.

23 Ibid., note 11.

24 Ibid., note 12.

25 Ibid., note 13.

Manitoba

On 1 October 2012, Manitoba became the fifth Canadian province to enact franchise legislation under the Franchises Act as well as its accompanying regulations (the Manitoba Act). Key features of the Manitoba Act include the duty of fair dealing on all parties,[26] the franchisee's right to associate,[27] the franchisor's obligation to disclose[28] and the franchisee's right to rescind the franchise agreement.[29] These provisions are largely similar to the franchise legislation enacted in the other provinces.

However, the one distinguishing feature between the Manitoba Act and other franchise laws in other provinces involves the possibility of disclosing in parts. In this regard, careful consideration should be given to the regulations regarding disclosure in parts in order to ensure that the requirements are met. In any event, franchisors must provide a certificate containing a statement contained in Form 1 of the Disclosure Document Regulation[30] when delivering the portion of the disclosure document.

Another key distinguishing feature is the possibility of delivering the disclosure document in electronic form. As well, Section 5(10) of the Manitoba Act stipulates that franchisors comply with their disclosure obligations if they 'substantially comply' with them. Franchise law practitioners have suggested that a franchisor could comply with the Manitoba franchise legislation even if a disclosure document contains a technical irregularity or mistake not affecting the substance of the document. As a result, technical irregularities that franchisees in some of the other provinces have been relying upon to claim rights of rescission may not be available in Manitoba.[31]

In addition, the Manitoba Act also provides for the electronic delivery of documents. In addition, under Section 5(14) of the Manitoba Act, a franchisor may collect the fully refundable deposit, which will not be construed as 'consideration relating to a franchise', such maximum deposit being the lesser of C$100,000 or 20 per cent of the initial franchise fee charged by the franchisor. The Manitoba Act allows franchisors to continue using a franchise disclosure document across the country. Finally, the Manitoba Act, as in other jurisdictions, allows the franchisees to rescind the franchise agreement no later than 60 days after having received the disclosure document if the franchisor failed to provide same or a statement of material change within the required time. The 14-day cooling-off period also applies in Manitoba.

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26 Ibid., Section 3.

27 Ibid., Section 4.

28 Ibid., Section 5.

29 Ibid., Section 6.

30 C.C.S.M. c. F156.

31 Snell, Peter, 'What You Need to Know About Manitoba's New Franchises Act', *The Franchise Lawyer*, American Bar Association Forum on Franchising, Vol. 15, No. 3.

V TAX

i Withholding taxes

A foreign franchisor may decide to expand its operations in Canada by franchising from its foreign home office or by establishing a branch office in Canada to provide a local base from which to administer a Canadian system and provide services. Setting up a branch operation generally allows the franchisor to maintain direct control over selection, training and administration of its franchise system. Amounts paid by a Canadian to a non-resident as interest, dividends, rents, royalties or most any other form of income from property are subject to Canadian withholding tax. The rate is 25 per cent but may be reduced under an applicable tax treaty. However, in the case of rents and respective Canadian real property, the rate may remain at 25 per cent. Canada has eliminated withholding tax on interest payments to non-residents who deal at arm's length with the payer, to the extent that the interest does not constitute 'participating debt interest', as defined in the Income Tax Act (Canada).[32]

Withholding taxes will be payable in respect of income earned by a non-resident on its investments in Canadian property, whether the Canadian payer is a subsidiary or is unrelated to the non-resident receiving the payment. The taxes are levied on non-residents, but are required to be collected by the Canadian payer and remitted to the Canadian authorities. Property or investment income that would normally be subject to withholding tax, but when it is attributable to a Canadian business carried on by a non-resident directly, is generally included in the branch's business income and is not subject to withholding tax, although the Canadian payer is required to obtain the consent of the Canada Revenue Agency not to withhold. In addition, the province of Ontario indirectly levies a 5 per cent withholding tax on management or administration fees and on rents, royalties and similar payments when paid to related non-residents, such as a parent company. Dividends and interest are not subject to this rule. Payment of withholding tax usually will allow the non-resident to claim a foreign tax credit for its own income tax purposes, although this should be confirmed by a foreign entity's domestic tax adviser.

The tax advantages of a branch structure include the fact that there is no Canadian income tax liability if the foreign franchisor has no permanent establishment in Canada provided the income is active; if the franchisor has no permanent establishment in Canada, Canadian income tax paid should qualify as a credit in its own jurisdiction and if the franchisor is a US corporation, the first C$500,000 is not subject to Canadian income tax; if the investment is made through a subsidiary, all dividends paid to the US franchisor subject to a 5 per cent dividend tax, losses from the Canadian branch will typically reduce taxable income in the home jurisdiction and in the case of passive income, it will be subject to Canadian withholding tax; and foreign franchisors should obtain a tax credit in their home jurisdiction if Canadian tax is paid in Canada. The tax disadvantages of a branch structure include the fact that the tax is payable at the time income is earned on an accrual basis rather than when income is paid to the foreign

32 R.S.C., 1985, c. 1.

jurisdiction and the risk that tax authorities will ensure that payments to the foreign franchisors are passive income subject to a flat withholding tax on gross income paid.

Foreign franchisors establishing a branch in Canada will need to register with a number of authorities, including the official corporation registry in each of the ten provinces and in the three territories in Canada where the foreign franchisor carries on business, the Canada Revenue Agency, authorities in the municipality and the province or territory where a branch carries on business, and employees of the franchisor will need to obtain Canadian work permits or visas.

Alternatively, the foreign franchisor may decide to establish a Canadian subsidiary. This structure may provide an effective shield for franchisors seeking to insulate themselves from the liability of potential losses or liabilities in Canada. Assets of the foreign franchisor may be transferred on a tax-free basis, which may be granted by way of a licence. A subsidiary may be incorporated federally or provincially. A federal corporation must maintain at least one director who is a Canadian citizen ordinarily resident in Canada and present at directors' meetings for a quorum to be formed. Some provinces and territories also have residency requirements; others do not. A special category of incorporation known as an unlimited liability corporation (ULC) is available in Nova Scotia. A shareholder of a ULC does not have limited liability and therefore will be liable for the ULC's debts and liabilities. Furthermore, a US-resident shareholder will be subject to US income tax on the income or losses of the ULC entitled to benefit from foreign tax credits in respect of Canadian income tax payable.

The notion of passive or active income is irrelevant in the case of a subsidiary. Income tax on net income is calculated on those rates that would be applicable if the non-resident parent carried on business in Canada (33 to 39 per cent). No branch tax is payable on the subsidiary's income. The dividends paid by the subsidiary will be subject to a withholding tax of 25 per cent (or less in case of a treaty). The Canadian tax liability of the subsidiary does not usually qualify for tax credit in a foreign jurisdiction.

Advantages of a subsidiary structure include the avoidance of the risk of withholding tax on passive income and that dividends are not taxed until paid, where any branch tax will be payable when earned. Disadvantages of the subsidiary structure include the fact that losses in the Canadian subsidiary cannot be used to reduce the parent income and home tax liability. Canadian income tax cannot usually qualify as a foreign tax credit in calculating the parent's income tax liability in its home jurisdiction and there is no withholding tax option if the income is passive.

A commonly used and effective structure is that of a Canadian subsidiary because of the advantages discussed above, the most significant of which will be to insulate the foreign franchisor from losses or liabilities in its own jurisdiction.

ii Franchisee tax liabilities

Canadian franchisees will be subject to Canadian taxes of all levels (i.e., federal, provincial and municipal), where applicable. In addition, payments to a branch of the foreign franchisor or a subsidiary may be subject to the withholding taxes discussed above, as the case may be.

VI IMPACT OF GENERAL LAW

i Agency, distributor, licence and other models

Save for the franchise laws enacted in the five noted Canadian provinces, and subject to the provisions of the Trademarks Act, there are no specific agency or distributor-type laws in Canada. Consequently, the definitions of what constitutes a franchise under the different laws enacted in those provinces that have franchise legislation will determine the necessity to comply with those laws. In the event that the business model does not fit into the description of a franchise, the pre-sale disclosure and other features of the franchise laws should not apply.

ii Employment law

Inasmuch as franchisees are not considered by way of contract and in fact as employees of the franchisor but rather independent contractors operating their own businesses, Canadian employment laws, both federal and provincial, should not apply to franchisors save for their own true employees.

iii Consumer protection

Consumer protection is provincially regulated under the Constitution Act.[33] Consumer protection of the various provincial laws may affect certain industries involving the sale of goods, credit, performance of service agreements with consumers, warranties, motor vehicles and a host of other areas. Though franchisees are generally subject to consumer protection legislation because they deal with the consumer directly, franchisors may also be subject to such legislation notably for vicarious liability, management of personal information or because they are involved in a relationship with the consumer. Foreign franchisors would be well advised to consult with Canadian counsel in those Provinces where they plan to carry on business to determine the impact of consumer protection laws.

iv Competition law

The federal Competition Act[34] governs competition and antitrust in Canada and applies to franchisors, franchisees and suppliers. The Competition Act stipulates substantive antitrust or competition rules and frames its administration. There are no provincial competition laws in Canada, although some provinces have active consumer protection as noted above. In addition, the common law doctrine on restraint of trade may apply to private agreements that limit competition.

33 Ibid., note 8.

34 R.S.C., 1985, c. C-34.

The Competition Act is divided into various parts. Some involve criminal offences which include conspiracies that unduly lessen competition, bid rigging, price fixing, predatory pricing, price discrimination and knowingly or recklessly falsifying material or making misleading representations to the public. Imprisonment, fines and prohibition orders are some of the sanctions that may be imposed. The provisions of the Competition Act are considered to be 'reviewable practices'. They include mergers, abuse of a dominant position, refusal to deal, tied selling, market restrictions and exclusive dealing. The Competition Act also addresses deceptive marketing practices which includes misrepresentations to the public, sales above advertised prices and promotional contests. They are considered 'reviewable contracts'.

Administratively, the competition tribunal has jurisdiction over the application of the Competition Act. The Competition Bureau is responsible for the administration of the Competition Act and directs investigations of alleged breaches. The following practices addressed by the Competition Act can apply in franchising:

Abuse of dominance

In contrast to the United States' Sherman Antitrust Act[35] where the unilateral acquisition of dominance itself may be subject to sanction, abusive dominance in Canada is a reviewable matter under the Competition Act.

Exclusive dealing

Exclusive dealing may arise where franchisors require their franchisees to purchase certain supplies from the franchisor or another company designated by the franchisor. The Competition Bureau may investigate the practice where it impedes entry or expansion of a supplier or product in a market or has another exclusionary effect to significantly lessen completion.

Tied selling

Tied selling occurs when a franchisor or another supplier requires that the purchaser acquire another product from the supplier or its nominee or refrain from purchasing certain types of products. The Competition Bureau may intervene in cases where tied selling once again impedes entry or expansion thereby significantly lessening competition.

Market restrictions

Market restrictions involve a franchisor or another supplier requiring that the sale of products be restricted to a defined territory or imposing a penalty if the franchisee or customer conducts business outside the territory.

Refusal to deal

In this case, the purchaser must be substantially affected in its business or precluded from carrying on business because it is unable to find an adequate supply of the product on usual trade terms.

35 Sherman Antitrust Act, 15 U.S.C. & 1-7.

Conspiracies/restraint of trade

Subsection 45.1 of the Competition Act creates a criminal offence for conspiracies, cartels and other agreements that would likely prevent or lessen competition unduly or would otherwise restrain or harm competition.

Price maintenance (and suggestive retail pricing)

It is a reviewable practice under the Competition Act for a producer or supplier, a person who extends credit or a person who has exclusive intellectual property rights, through an agreement, threat, promise or like means to attempt, directly or indirectly, to influence or discourage the reduction of the price of a product sold in Canada. Price maintenance may occur when a supplier prevents a customer from selling a product below a minimum price by means of a threat, promise or agreement. It may also occur when a supplier refuses to supply a customer or otherwise discriminates against it because of its low pricing policy.

For the Competition Act to apply, the following requirements must be met:

a a supplier, by means of a threat, promise or agreement, influences upward, or discourages the reduction of, the prices charged or advertised by another business that is either a customer of that supplier, or a competitor;

b a supplier refuses to supply a product to, or discriminates against, another person because of that other person's low pricing policy; and/or

c any person, as a condition of doing business with a supplier, induces that supplier to refuse to supply a product to another person because of that other person's low pricing policy; and

d the conduct described above has had, is having or is likely to have an adverse effect on competition in a market.

False or misleading advertising and labelling

The misleading advertising and labelling provisions enforced by the Competition Bureau prohibit making any deceptive representations for the purpose of promoting a product or business interest, and encourage the providing of sufficient information to allow consumers to make informed choices. False or misleading representations are considered to be deceptive marketing practices under the provisions of the Competition Act and contain a general prohibition against materially false or misleading representations. They also prohibit making performance representations that are not based on adequate and proper tests, misleading warranties and guarantees, false or misleading ordinary selling price representations, untrue, misleading or unauthorised use of tests and testimonials, bait and switch selling, double ticketing, and sale of a product above its advertised price. Further, the promotional contest provisions prohibit contests that do not disclose the required information.

The Competition Act provides criminal and civil regimes to address false and misleading representations. Under both regimes, the Competition Act prohibits the making, or permitting of the making, of a representation to the public, in any form whatsoever, that is false or misleading in a material respect.

v Restrictive covenants

In Canada, restrictive covenants will generally be enforced if they contain reasonable restrictions on trade and if their geographic scope and duration are reasonable. Franchisors would be well advised to be more conservative in setting out the terms of the covenants contained in their agreements or they risk court challenges. In general, in-term non-competition covenants will tend to be farther reaching and may potentially find application beyond Canadian borders except in the province of Quebec, where the geographic scope of such provisions is more often scrutinised. Post-term non-competition provisions (upon expiration or termination of the agreement) must be reasonable and the courts will take a very strict approach in enforcing them. Finally, Canadian courts will generally not rewrite a non-competition covenant to make it reasonable and therefore enforceable. This rule has become known in Canadian law as the 'blue pencil test'. The in-term and post-term non-competition covenants contained in franchise agreements created for jurisdiction outside of Canada should therefore be carefully reviewed by a knowledgeable franchise lawyer before they are used.

vi Termination

Aside from the rights of rescission set out in the various legislation found in the five provinces noted above, there are no set termination provisions or restrictions imposed on franchisors. The franchise agreement generally sets out the grounds upon which the franchisor may terminate the franchise agreement. Some of these grounds can result in immediate termination while others require giving a franchisee notice and time to cure the default prior to the termination coming into effect. Unlike some jurisdictions in the United States, there are no statutory definitions in Canada of 'good cause' to warrant what constitutes a default or acceptable grounds for denying a renewal or transfer. In Canada, this situation would be guided by the duty of good faith and fair dealing under the various franchise laws in some of the Canadian provinces and under the Civil Code of Quebec.

vii Anti-corruption and anti-terrorism regulation

The anti-bribery provisions of the Criminal Code

Part IV of Canada's Criminal Code ('Cr.c.') concerning offences against the administration of law and justice includes provisions dealing with corruption of an official.[36] Section 121 Cr.c. makes it a crime to, directly or indirectly, give or offer to give, a loan, reward, advantage or benefit of any kind to an official in order for the latter to exercise his or her influence, act or omit to act in connection with government business. Everyone who commits an offence under Section 121 Cr.c. is guilty of an indictable offence and liable to imprisonment for a term not exceeding five years.[37] The provisions concerning corruption, notably Section 121 Cr.c. are applicable to persons doing business with the

36 Criminal Code, R.S., 1985, c. C-46, Section 118, defines official as a person who (1) holds an office; or (2) is appointed or elected to discharge a public duty.

37 Criminal Code, R.S., 1985, c. C-46, Section 121(3).

government of Canada and with the provincial governments and do not address the issue of foreign corrupt practices.

The implementation of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the Act Respecting the Corruption of Foreign Public Officials

In contrast to the United States, which enacted the Foreign Corrupt Practices Act (FCPA) in 1977, Canada did not adopt specific anti-corruption legislation until 1999 when it enacted the Corruption of Foreign Public Officials Act (CFPOA).[38] The CFPOA was enacted following the signing by Canada, on 17 December 1997, of the new Anti-bribery Convention negotiated under the auspices of the Organisation for Economic Co-operation and Development (OECD). Pursuant to this Convention,[39] it is a crime for companies and individuals that do business abroad to bribe public officials in foreign countries.[40]

The OECD Convention requires member countries to adopt within their domestic jurisdictions legislation that criminalises bribery in the international context. The OECD Convention does not impose a set of rules but rather allows member countries to adopt their own rules that must meet the stipulated standards. In particular, Article 1 of the OECD Convention provides as follows:

> *Each party shall take such measures as may be necessary to establish that it is a criminal offence under its law for any person intentionally to offer, promise or give any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business.*

As a result, on 1 December 1998, the CFPOA received royal assent and came into force on 14 February 1999. The effectiveness of a national anti-corruption law requires both rigidity in its result and flexibility in its application.[41] This was precisely what was

38 Concerning the application of the Foreign Corrupt Practices Act to non-US corporations and individuals see: Robert A Bassett, 'Canadian Companies Beware: the U.S. Foreign Corrupt Practices Act to You!', (1998) Alta. L. Rev. 455.

39 Criminal Code, R.S., 1985, c. C-46, Section 121(3).

40 Juliette D'Hollander, 'Ethics in business: The new OECD Convention on Bribery', (1999) 33 R.J.T. 147-166.

41 Jean-Claude Hébert, *Droit Pénal des Affaires*, 2002, Cowansville, Éditions Yvon Blais, p. 372.

intended by Parliament when it defined in the CFPOA the concepts of 'business',[42] 'foreign public official'[43] and 'foreign state'.[44]

Bribing a foreign public official under the CFPOA consists in offering or agreeing to give or offer a loan, reward, advantage or benefit of any kind to a foreign public official, or to a person for the benefit of a foreign public official, in order to obtain or retain an advantage in the course of business. Pursuant to the CFPOA, a person who bribes a foreign public official is guilty of an indictable offence and liable to imprisonment for a term not exceeding five years. A 'person' in accordance with the CFPOA includes an organisation.[45]

Canadian franchisors need to bear this legislation in mind when negotiating international business transactions or operating in a foreign state. It is evident that if any franchisor contravenes the provisions of the CFPOA, it could be held responsible and eventually be indicted. For example, if a Canadian franchisor decides to expand its international operations and develop a system in a foreign country and, in doing so, it provides an advantage to a foreign public official to obtain certain authorisations, said franchisor could be in violation of the CFPOA. However, it remains to be determined whether a Canadian franchisor could be held responsible for the acts of a third party who violates the provisions of the CFPOA. In this regard, it is recommended to specifically inform any party that has some kind of power of attorney or mandate from the franchisor that they are prohibited from offering or giving an advantage to any foreign public official in the course of their business. It is further recommended that companies require approval from internal counsel for all proposed payments to foreign public officials.

Anti-terrorism laws

In 2001, after the 9/11 attacks, the Canadian Parliament enacted the Anti-Terrorism Act[46] (ATA), which brought significant amendments to the Criminal Code, the Official

42 Section 1 of the CFPOA defines business as any business, profession, trade, calling, manufacture or undertaking of any kind carried on in Canada or elsewhere for profit.

43 Section 1 of the CFPOA defines foreign public official as:
(a) a person who holds a legislative, administrative or judicial position of a foreign state; (b) a person who performs public duties or functions for a foreign state, including a person employed by a board, commission, corporation or other body or authority that is established to perform a duty or function on behalf of the foreign state, or is performing such a duty or function; and (c) an official or agent of a public international organization that is formed by two or more states or governments, or by two or more such public international organizations.

44 Section 1 of the CFPOA defines 'foreign state' as a country other than Canada, and includes:
(a) any political subdivision of that country; (b) the government, and any department or branch, of that country or of a political subdivision of that country; and (c) any agency of that country or of a political subdivision of that country.

45 Section 1 of the CFPOA provides that 'person' means a person as defined in Section 2 of the Criminal Code.

46 Act to amend the Criminal Code, the Official Secrets Act, the Canada Evidence Act, the Proceeds of Crime (Money Laundering) Act and other Acts, and to enact measures respecting the registration of charities in order to combat terrorism, Bill C-36 (2001).

Secrets Act, the Canada Evidence Act, the Proceeds of Crime (Money Laundering) and Terrorist Financing Act and other legislation. Section 145 of the ATA provides that, within three years following royal assent of the ATA, a comprehensive review of the provisions and operations of the ATA must be undertaken by such committee of the Senate, the House of Commons or both. Such reviews did take place by both the House of Commons and the Senate and caused amendments to be made with respect to the procedure relating to immigration security certificates.[47]

Of particular interest to franchise systems are the amendments to the Proceeds of Crime (Money Laundering) and Terrorist Financing Act[48] (PCA), which was amended to expand the mandate of the Financial Transactions and Reports Analysis Center (FINTRAC). FINTRAC is an independent federal agency which receives information from a wide range of financial institutions and intermediaries such as banks, credit unions, trust and loan companies, securities dealers, brokers and agents, accountants or accounting firms, money services businesses and other institutions. It is estimated that approximately 300,000 entities are subject to the reporting requirements of the PCA.

The PCA imposes obligations with respect to record keeping, identity checks, reporting of suspicious transactions and registration requirements[49] for entities enumerated in Section 5 of the PCA.[50] In particular, these obligations are imposed on 'money services businesses', which are persons and entities engaged in the business of foreign exchange

47 Bill C-3, An Act to Amend the Immigration and Refugee Protection Act (Certificate and Special Advocate) and to Make a Consequential Amendment to Another Act, was introduced in the House of Commons on 22 October 2007. Bill C-3 received Royal Assent on February 14, 2008 and was proclaimed into force on 22 February 2008.

48 Proceeds of Crime (Money Laundering) and Terrorist Financing Act, (2000, c. 17).

49 For more on the PAC see: Alan D. Gold's Money Laundry Database, Proceeds of Crime (Money Laundering) and Terrorist Financing Act, Canada Gazette, Part II, Vol. 136, No. 7 (14 May 2002).

50 Section 5 of the PCA reads as follows:

5. This Part applies to the following persons and entities:

(a) authorized foreign banks within the meaning of section 2 of the Bank Act in respect of their business in Canada, or banks to which that Act applies;

(b) cooperative credit societies, savings and credit unions and caisses populaires regulated by a provincial Act and associations regulated by the Cooperative Credit Associations Act;

(c) life companies or foreign life companies to which the Insurance Companies Act applies or life insurance companies regulated by a provincial Act;

(d) companies to which the Trust and Loan Companies Act applies;

(e) trust companies regulated by a provincial Act;

(f) loan companies regulated by a provincial Act;

(g) persons and entities authorized under provincial legislation to engage in the business of dealing in securities or any other financial instruments, or to provide portfolio management or investment advising services;

(h) persons and entities engaged in the business of foreign exchange dealing, of remitting funds or transmitting funds by any means or through any person, entity or electronic funds transfer

dealings, remitting funds or transmitting funds or issuing or redeeming money orders, travellers cheques or other similar negotiable instruments, with the exception of cheques payable to a named person or entity. The definition of a 'money services business' is broad and of particular concern to certain franchise systems. For example, businesses engaged in issuing or redeeming money orders and travellers cheques, such as hotels or convenience stores, should consider that they could be subject to the record-keeping requirements of the PCA.

In addition to the record-keeping requirements, it is provided that every person subject to the PCA must report to FINTRAC every financial transaction that occurs or that is attempted in the course of its activities and in respect of which there are reasonable grounds to suspect that (1) the transaction is related to the commission or the attempted commission of a money laundering offence; or (2) the transaction is related to the commission or the attempted commission of a terrorist activity financing offence.[51] These penalties are applicable to officers, directors or agents of a corporation who participated in committing an offence.[52]

In order to avoid penalties provided under the PCA, franchisors, prior to completing transactions, must conduct proper due diligence as to the nature and control of the entities involved in these transactions. This would evidently include a verification of Canada's terrorist list[53] (the Canadian Terrorist List). The Canadian Terrorist List identifies entities involved in terrorist activities or that are acting on behalf of such entities. It may also be useful to require certain representations and certifications from the entities involved in transactions with respect to any relation to an entity listed on the Canadian Terrorist List.

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network, or of issuing or redeeming money orders, traveler's cheques or other similar negotiable instruments except for cheques payable to a named person or entity;

(i) persons and entities engaged in a business, profession or activity described in regulations made under paragraph 73(1)(a);

(j) persons and entities engaged in a business or profession described in regulations made under paragraph 73(1)(b), while carrying out the activities described in the regulations;

(k) casinos, as defined in the regulations, including those owned or controlled by Her Majesty;

(l) departments and agents of Her Majesty in right of Canada or of a Province that are engaged in the business of accepting deposit liabilities, that sell money orders to the public or that sell prescribed precious metals, while carrying out the activities described in regulations made under paragraph 73(1)(c); and

(m) for the purposes of section 7, employees of a person or entity referred to in any of paragraphs (a) to (l).

51 Paul Walker and Katrina Roth Von Szepesbela, 'Silence is gold – Or is it? FINTRAC and the Suspicious Transaction Reporting Requirements for Lawyers', (2004) Asper. Rev. of Int'l Bus. and Trade Law, 85-130; John Jaffey, 'Seminar told of far-reaching impact of money laundering law', *Lawyers Weekly*, Vol. 21 No. 27 (16 November 2001).

52 Proceeds of Crime (Money Laundering) and Terrorist Financing Act, (2000, c. 17), Section 78.

53 Regulations Establishing a List of Entities pursuant to Section 83.05(1) of the Criminal Code.

viii Dispute resolution

As previously mentioned, the administration of justice in Canada is a provincial jurisdiction under the legal jurisdiction of the provinces under their powers to regulate property and civil rights issues in the province. The legal systems in all Canadian provinces other than the province of Quebec are based on English common law. The Quebec legal system is based on civil law. The courts of Canada are divided into federal courts, which have limited jurisdiction to deal only with matters regulated under federal laws, and courts of each province, which are of general jurisdiction. Each province has a series of lower courts and a Superior or Supreme Court as well as a Court of Appeal. Appeals from provincial courts are heard, if appeal is granted (only in significant cases generally of national importance), by the Supreme Court of Canada, the highest court in the country, from which there is no appeal.

Most disputes tend to be addressed before the courts rather than by arbitration. Arbitration is generally perceived as costly and not necessarily more expedient. However, it is nonetheless recognised as an effective method of dispute resolution. Mediation is also commonly used and, in certain provinces, mandatory under the various franchise acts and other legislation enacted in certain provinces. Canadian courts will generally enforce a choice of law provision contained in franchise or other agreements with the exception that provisions purporting to exclude the application of provincial franchise laws are deemed to be null.

There are no specific procedures or industry practices for franchising disputes other than those mentioned above. It should be noted that the use of jury trials in civil matters in Canada (excluding Quebec where there are no jury trials in civil matters) is very limited. Juries are possible but extremely rare. Cases involving franchise matters will generally be heard by a judge alone. A dispute is normally brought by filing a claim and, depending on the nature of the remedy sought, can take anywhere from six months to two years or more to be brought to trial. In addition, some courts have established special divisions where commercial matters can proceed on a faster track. Injunctive or other equitable remedy can generally be obtained to enforce certain provisions of franchise agreements such as a restrictive covenants or the violation of intellectual property rights, and proceed more quickly. Awards for damages in Canadian civil trials generally fall on the following categories: general direct damages, special damages, aggravated damages and punitive damages. Costs are generally awarded to the winning party and payable by the losing party, absent special circumstances. The exception to this rule lies in the province of Quebec, where costs on a solicitor-client basis can generally only be awarded in cases of abuse of the legal process or where provided in the franchise agreement.

The enforcement of foreign judgments or awards (whether from courts or as a result of arbitration decisions) are generally enforceable and special rules will apply in such cases in the various provinces. Canada is a signatory of the United Nations Convention on the Recognition and Enforcement of Foreign Arbitration awards (the New York Convention) and local courts will generally recognise foreign arbitral awards from another convention country.

VII CURRENT DEVELOPMENTS

Canada has seen two very significant franchise cases litigated before the courts in the past few years. The first involves TDL Group Corporation, which operates the Tim Hortons franchise system, one of the largest in Canada, also present in the United States and abroad. The case involved a class action claiming C$1.8 billion in damages resulting notably from system changes brought about by the franchisor. The case was ultimately dismissed on summary judgment and confirmed in appeal. Leave to the Supreme Court was denied.

In contrast, the other case involves Dunkin' Donuts, one of the largest franchisors in the world. A small group of franchisees sued the franchisor for over C$16 million based on a number of grievances including the decline of the brand in the province of Quebec. The franchisees prevailed in the Superior Court of Quebec and the case is currently under appeal before the Quebec Court of Appeal.

Finally, as previously noted, the province of British Columbia is currently examining the possibility of enacting franchise legislation in that province.

Appendix 1

ABOUT THE AUTHORS

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Stéphane Teasdale, chair of the international franchise and distribution law group and co-head of the commercial group in the Montréal office of Dentons, is a leading practitioner in the area of commercial law, and is renowned in Canada and abroad for his unique expertise in the area of franchising. For almost 25 years he has provided legal and strategic counsel in transactional and litigation matters dealing with corporate, commercial and business law, franchising, competition and intellectual property.

Stéphane advises prominent Canadian franchise systems expanding internationally, as well as Canadian, American and foreign franchise and distributions systems wishing to establish themselves or expand in Canada, particularly in Quebec. Stéphane also advises several Canadian networks that have opened and expanded internationally into markets in Europe, North Africa and Australia.

Actively involved in Canadian, American and international franchise associations, Stéphane is currently the vice-president and an executive committee member of the Quebec Franchise Council. He is recognised in Canada, the United States and abroad as one of the few experts in franchise law in Quebec and Canada, an honour that has been repeatedly acknowledged by *The Canadian Legal Lexpert Directory*, *The Best Lawyers in Canada 2013*, *Who's Who Legal: Canada 2013* and, for many years, the *Franchise Times* magazine.

In both domestic and international forums, Stéphane is a frequent lecturer on franchise and distribution matters related to markets locally, nationally and internationally. He is also an author of numerous published articles.

A graduate of the University of Ottawa Faculty of Law, the Université du Québec School of Business and Queen's School of Business, Stéphane was called to the Quebec Bar in 1988, and is a member of the Canadian, American and International Bar Associations.

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