



## **THE INADVERTENT FRANCHISE**

26th Annual IBA/IFA Joint Conference  
***“Managing Risks in International Franchising”***  
May 18-19, 2010

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# **THE INADVERTENT FRANCHISE<sup>1</sup>**

## **I. Introduction**

Prior to the emergence of franchise legislation, franchising was a matter of contract. Recognizing a need to improve fair dealing in franchise relationships and to provide prospective franchisees with sufficient information to make an informed decision about investing in the franchise, franchise legislation has been increasingly adopted by governments around the globe. However, the broad language used in defining a franchise relationship common to such legislation has created a risk that other legal relationships, such as agency, licenses, dealerships and distributorships, could be caught.

There are serious consequences for businesses that fail to recognize that they are creating in their documentation a franchise relationship governed by franchise legislation.

This paper will explore how other distribution models may become franchises, the resulting consequences and how to avoid such circumstances and consequences. This paper is not intended to be a fulsome survey of international franchise laws but instead a snapshot of the treatment of inadvertent franchises in selected countries. This paper will not consider inadvertent franchising under US franchise law. For a detailed treatment of International franchise law the reader is directed to the American Bar Association's publication entitled "International Franchise Sales Law".<sup>2</sup>

## **II. The Industry Definition and What Agreements May Get Caught?**

The International Franchise Association defines a franchise (the "Industry Definition") as an agreement or license between two legally independent parties that gives:

- A. a person or group of people (franchisee) the right to market a product or service using the trademark or trade name of another business (franchisor);
- B. the franchisee the right to market a product or service using the operating methods of the franchisor;
- C. the franchisee the obligation to pay the franchisor fees for these rights; and
- D. the franchisor the obligation to provide rights and support to franchisees.

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<sup>1</sup> The authors acknowledge, with appreciation, the significant contribution to this paper of Dalia Hamdy, student-at-law, Gowling Lafleur Henderson LLP.

<sup>2</sup> A. Loewinger and M. Lindsey, *International Franchise Sales Laws*, American Bar Association Publishing

The Industry Definition demonstrates the breadth and potential reach of the various components of the definition. Countries are literally and figuratively “all over the map” in terms of the various combinations of these elements, as well as others, that might comprise a country’s franchise definition. Consequently, there are various common forms of contractual relationships containing some combination of these elements that are susceptible of becoming an “inadvertent franchise”:

A. Sales Agency Agreements. Sales Agency agreements focus on the agent’s authority, the territory (exclusive or not) in which the agent will operate, the terms of the agreement, the amount and payment of remuneration to the agent and what happens on and after termination.

B. License Agreement. License Agreements deal primarily with the licensor’s remuneration for granting the license rights and the passing on to the licensee of the necessary information and know-how. When the license arrangement is more involved, it may also deal with such matters as the mode and standard of production, future improvements, territory, term, quotas and marketing.

C. Distribution Agreements. A pure distribution arrangement is usually merely a continuing relationship between a purchaser and vendor of particular goods which may or may not include use of the vendor’s trademark. Distribution arrangements between a distributor and a captive group of retailers are particularly susceptible to creating a franchise relationship.

### III. What is a Franchise under Applicable Country Law?

Quite a number of countries have enacted franchise legislation. The following table is a quick reference guide to various countries and what they consider to be a franchise and the consequences of non-compliance.

Country	What is a franchise?- Elements of Definition	Consequences of Non-Compliance
Australia	<p>An agreement, which can be written, oral or implied. The agreement grants the right to carry on the business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or its associate;</p> <p>The business will be substantially or materially associated with a trademark, advertising or commercial symbol owned or specified by the franchisor or its associate;</p> <p>A requirement to pay a fee or other payment</p>	<p>Injunction or damages to recover the loss suffered.</p> <p>Void/Rescission of franchise agreement</p>

Country	What is a franchise?- Elements of Definition	Consequences of Non-Compliance
	<p>prior to or during the term of the agreement such as an initial capital investment fee, payment for goods or services, royalty fee or training fee; or</p> <p>The business must show that they have implemented a 'system or marketing plan'.<sup>3</sup></p>	
Belgium	<p><i>"agreements of commercial partnership concluded between two parties "in which "one of the parties concedes to the other party the right , in return for a fee of any nature, either direct or indirect,.... to use, in view of the sale of products or the providing of services , a commercial formula which includes one or more of the following: (1) a common brand (2) a common commercial name (3) the transfer of know-how or (4) the provision or technical or commercial assistance".</i></p>	Voiding of Contract
Canada	<p>A right to engage in a business where the franchisee is required to make a payment to the franchisor in the course of operating the business or as a condition of acquiring the franchise or commencing operations and in which the franchisor grants to the franchisee the right to sell goods or services that are substantially associated with the franchisor's trade-mark, trade name, logo or advertising or other commercial symbol, and the franchisor exercises significant control over, or offers significant assistance in the method of operation, or in which the franchisor grants the franchisee representational or distribution rights to sell goods or services supplied by the franchisor or the franchisor's designate and the franchisor provides location assistance to the franchisee</p>	<p>Void/Rescission of franchise agreement</p> <p>Repayment of investment by franchisee, plus any losses</p> <p>Right of Action for Damages</p>
Estonia	<p>By a franchise contract, one person (the franchisor) undertakes to grant to another person (the franchisee) a set of rights and information which belongs to the franchisor for use in the economic or professional activities of the franchisee, including the right to the trademark commercial identifications and know-how of the franchisor.</p> <p>No pre-contractual disclosure obligations</p>	
France	<p>Any person who puts at the disposal of another person a trade name, trademark or commercial symbol, while requiring from such other person</p>	<p>Government Fines</p> <p>Voiding/Rescission of</p>

<sup>3</sup> See *ACCC v. Kyloe Pty Ltd.*, [2007] FCA 1552.

Country	What is a franchise?- Elements of Definition	Consequences of Non-Compliance
	<p>a commitment of exclusivity, or quasi-exclusivity with respect to the conduct of such other person's business.</p> <p>(so called <i>Loi Doubin</i>)</p>	<p>Contracts</p> <p>Damages</p> <p>Criminal Penalties</p>
Georgia	<p>A franchise agreement is a long-term relationship whereby independent enterprises reciprocally undertake, where necessary, to promote the production and marketing of goods and provision of services by performing specific obligations.</p>	
Italy	<p>An agreement between two legally and financially independent parties, whereby one party grants the other party, in exchange for consideration, the right to use a set of industrial or intellectual property rights, related to trademarks, trade names, shop signs, utility models, industrial designs, copyright, know-how, patents, technical and commercial support and assistance, with a view to the Franchisee joining the system characterized by a group of franchisees operating in the territory, for the purpose of distributing specific goods and services.</p>	<p>Government Fines</p> <p>Void/Rescission of the agreement</p> <p>Damages</p> <p>Criminal penalty for fraud of up to two years imprisonment or up to 2,065.83 Euro.</p>
Lithuania	<p>Under a franchise contract, one party (the right holder) shall undertake to grant the other party (the user) for a remuneration and for a specified or unspecified period of time the right to use in the course of the user's entrepreneurial activity a complex of exclusive rights belonging to the right holder (the right to use the firm name, the trademark, the service mark, protected commercial information, and the like), in return the other party shall undertake to pay a remuneration stipulated by the contract.</p> <p>Registration, but no pre-contractual disclosure obligations.</p>	
Mexico	<p>A franchise exists, "<i>whenever, in conjunction with a license to use a trademark granted in writing, technical knowledge is transmitted or technical assistance is furnished in order to enable the licensee to produce or sell goods or render services in a uniform manner ...</i>"</p>	<p>Government Fines</p>
Romania	<p>a. <i>Franchise</i> means a marketing system based on a continuous operation between natural persons or legal entities, each of them financially independent from the others, whereby a person, called franchisor, grants to another person, called franchisee, the right to</p>	<p>Not provided in the ordinance itself.</p>

Country	What is a franchise?- Elements of Definition	Consequences of Non-Compliance
	<p>operate or to develop a business, a product, a technology or a service.</p> <p><i>b. Franchisor means a trader who/which:</i></p> <ul style="list-style-type: none"> <li>- <i>has ownership title to a registered mark; such title must be valid for at least as long as the duration of the franchise agreement; grants the right to operate or to develop a business, a product, a technology or a service</i></li> <li>- <i>gives the franchise an initial training for the operation of the registered mark</i></li> <li>- <i>uses personal and financial means to promote his/its mark, research and innovation, and ensures the development and viability of the product.</i></li> </ul> <p><i>c. Franchisee means a natural person or a legal entity dealing in the trading business who/which is selected by the franchisor and adheres to the principle of uniformity of a franchise network as defined by the franchisor;</i></p> <p><i>d. Know-how means the entirety of all formule, technical, definitions, drawings, patterns, networks methods and other similar elements serving for the manufacture and sale of a product.</i></p> <p><i>e. Franchise network means an assembly of contractual relationships between a franchiser and several franchisees for the purpose of promoting a technology product or service and for the development of the production and distribution of a product or service.</i></p> <p><i>Extensive pre-contractual disclosure obligations for the franchisor</i></p>	
Spain	An agreement or contract by which a company, known as the franchisor, grants to another, known as the franchisee, the rights to exploit its own system of commercialization of products and services.	Government fines  Void/rescission of the franchise agreement.

Country	What is a franchise?- Elements of Definition	Consequences of Non-Compliance
	<p>The law explicitly distinguishes as not being franchising:</p> <ul style="list-style-type: none"> <li>• exclusive distributions agreements</li> <li>• granting of manufacture license</li> <li>• transfer of a registered trademark to be used within a certain area</li> <li>• technology transfer</li> <li>• transfer of a common denomination or establishment sign.</li> </ul>	
Sweden	<p>An agreement by which an entrepreneur (the franchisor) agrees with someone else (the franchisee) that the latter against compensation paid to the franchisor shall use the special business idea of the franchisor for the marketing and sale of goods or services. As further conditions for an agreement to be considered a franchise agreement according to this law, is that the franchisee under the agreement shall use the distinctive trademarks and other intellectual property rights of the franchisor, as well as co-operate on the occasion of recurrent controls of the observance of the agreement.</p>	Injunction by Market Court

### A. Canadian Law Discussion

1. Focusing on Canadian law, the Acts<sup>4</sup> incorporate a broad definition of 'franchise'. Under all of the Acts, except Alberta's legislation, a franchise is defined as a right to engage in a business where the franchisee is required to make a payment or continuing payments to the franchisor in the course of operating the business or as a condition of acquiring the franchise or commencing operations and

(a) in which the franchisor grants to the franchisee the right to sell goods or services that are substantially associated with the franchisor's trade-mark, trade name, logo or advertising or other commercial

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<sup>4</sup> In 1971 Alberta became the first Canadian province to enact franchise legislation. In 1995, Alberta introduced a revised *Franchises Act*.<sup>4</sup> In 2000, Ontario became the second Canadian jurisdiction when it enacted the *Wishart Act*. In August 2005, the Uniform Law Conference of Canada (the "ULCC") adopted the *Uniform Franchises Act* (the "Model Bill")<sup>4</sup> and uniform regulations. Prince Edward Island enacted the *Franchises Act*,<sup>4</sup> modeled primarily on the ULCC Model Bill, in June 2005. In New Brunswick, Bill 32, the *Franchises Act*, was introduced in the New Brunswick Legislative Assembly on February 23, 2007. The *Franchise Act* was modeled after the PEI legislation.<sup>4</sup> The Canadian legislation will be collectively referred to as the "Acts".



symbol, and the franchisor exercises significant control over, or offers significant assistance in the method of operation, or

(b) in which the franchisor grants the franchisee representational or distribution rights to sell goods or services supplied by the franchisor or the franchisor's designate and the franchisor provides location assistance to the franchisee.

The *Wishart Act* differs slightly in that it refers to a 'service mark' as well as a trademark,<sup>5</sup> and the Alberta legislation is slightly narrower in scope. According to the ULCC Uniform Franchises Act Working Group, "*an inclusive definition of franchise was chosen in order to capture a wide range of relationships subject to requirements such as fair dealing but also to exempt certain others (i.e. business opportunities or multilevel marketing) from the disclosure requirements*".<sup>6</sup> The inclusive nature of the definition captures many contractual arrangements for which the parties never intended to create a franchise relationship.

When viewing the common elements of the Canadian statutory definition and the Industry Definition referred to above, one may determine that a franchisor/franchisee relationship exists if the arrangement meets the following three requirements: (i) the fee requirement (the required payment of money); (ii) the trademark requirement (substantial association with the franchisor's trademark); and (iii) the control requirement (by providing some form of control over or assistance in the manner of operation of the business). Counsel must analyze both the substance of the relationship that has been or is being created and the long-term goals that the client is attempting to achieve.

## 2. Consequences of Being an Unintentional Franchisor

Under Canadian law, the consequences of being an inadvertent franchisee are:

### (a) Disclosure

Franchisors typically have very significant pre-sale disclosure obligations under most of the prevailing franchise statutes. Under Canadian franchise law, franchisors are required to deliver a disclosure document to a prospective franchisee at least 14 days before the franchisee enters into an agreement or pays any money with respect to the franchise. The franchisor must also provide written statements of any material changes that occur before the agreement is signed or any money paid.

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<sup>5</sup> Supra note 1.

<sup>6</sup> Supra note 3.

(b) Franchisee's Remedies

Under the various franchise statutes, franchisees have prescribed remedies, which can be significant. In Canada, in addition to any other right or remedy that may exist at law, franchisees also have available to them a right of rescission and a right of action for damages.

(c) Right of Rescission

All of the Acts provide that the franchisee may rescind the franchise agreement within 60 days if the franchisor failed to provide the aforementioned disclosure documents within the time required, or, under all Acts except Alberta's, if the contents of the documents did not meet the statutory requirements. The time allowed for rescission increases to two years if the franchisor provided no disclosure document. Upon rescission, the franchisor must compensate the franchisee for any net losses that the franchisee has incurred in acquiring, setting up and operating the business. All Acts except Alberta's also specifically require the franchisor to refund money received from the franchisee and to buy back any remaining supplies, equipment and inventory sold to the franchisee at a price equal to the purchase price paid by the franchisee.

The issue of incomplete disclosure was considered by the courts in *6792341 Canada Inc. v. Dollar It Limited*.<sup>7</sup> The Ontario Court of Appeal concluded that, "*one of the prime purposes of the Act is to obligate a franchisor to make full and accurate disclosure to a potential franchisee so that the latter can make a properly informed decision about whether or not to invest in a franchise. When key information is missing, a properly informed decision is not possible.*"<sup>8</sup> The Court of Appeal decided that in light of the missing documents, which included an unsigned franchisor certificate, incomplete or no financial statements, no lease, no information on their affiliate, incomplete or missing information about the advertising fund and failure to describe the entire territory being granted, that whatever had been given to the franchisee was so deficient as not to have been considered a disclosure document at all. Since the rescission had taken place within the two year period, as required by 6(2), the Court of Appeal ordered that the franchisor comply with the statutory requirements, refund the fee, purchase inventory and supplies, and make good any losses.

(d) Right of Action for Damages

The Acts also provide a right of action for damages if a franchisee suffers a loss because of a misrepresentation in the disclosure document or statement of material change, or because of the franchisor's failure to comply with the disclosure requirements. In Alberta, the right of action arises against the franchisor and every person who signed the disclosure

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<sup>7</sup> 2009 ONCA 385.

<sup>8</sup> *Ibid.*, para. 17.

document or statement. The other Acts add to this list the franchisor's broker and the franchisor's associate (Ontario also adds the 'franchisor's agent').<sup>9</sup> All Acts except Alberta's legislation provide that a party has a right of action for damages against another party who breaches the duty of fair dealing, and that the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards. All Acts also provide that the duty of fair dealing applies retroactively to franchise agreements entered into before the legislation came into force.

### 3. Canadian Case Law.

In the 2003 Ontario Court of Justice case of *1368741 Ontario Inc. v. Triple Pizza (Holdings) Inc.*,<sup>10</sup> the prospective franchisee had signed a number of documents, paid a \$35,000 deposit and executed documents related to a vendor take back loan, but the actual closing had not taken place. The defendant, who had not provided any disclosure documents, took the position that since the closing had not taken place the plaintiff was not a franchisee and was not entitled to the remedies under the *Wishart Act*. The court ruled that the documents signed constituted a franchise arrangement. Therefore, the plaintiff was a franchisee under the *Wishart Act* and was entitled to rescission rights.

In the 2004 case of *Ahmed v. 3 for 1 Pizza and Wings (Canada) Inc.*,<sup>11</sup> the court stated that "to carry out the intent and purpose of the Act and to grant protection to subfranchisees investing in a franchise operation, the definition of "franchise" in the act must be given a contextual interpretation."

In the recent 2010 case of *Di Stefano v. Energy Automated Systems Inc*<sup>12</sup> Justice Code applied a three-part test to determine what constitutes a "franchise" under the Ontario Act. A group of ten plaintiffs, who had each signed "distributorship" agreements with Energy Automated Systems Inc. ("EASI"), claimed to be entitled to rescission of those agreements in accordance with Section 6 of the Ontario Act. At issue on a motion brought by EASI was whether the distributorships were "franchises" under the Ontario Act. The Court quickly concluded that the Payment Requirement and Trade-Mark Requirement had been met and focused its attention on the Significant Control/Assistance Requirement.

The plaintiff conceded that there was no evidence of significant control but argued that EASI had offered significant assistance in the form of a five day training program, prior to obtaining an EASI dealership. In deciding the issue, the Court held that a five day training program did not constitute significant assistance. Justice Code stated that:

Counsel for the Plaintiffs conceded during argument that the sole basis on which this test can be met is the five day training program, prior to obtaining an EASI dealership.

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<sup>9</sup> ULCC Uniform Franchises Act Working Group.

<sup>10</sup> [2003] O.J. No. 2922 (confirmed on appeal [2004]) O.J. No. 430. See also *Bekah v. 3 for 1 Pizza* [2003] 67 O.R. 3d 305.

<sup>11</sup> [2004] O.J.No. 144 (S.C.J.).

<sup>12</sup> 2010 ONSC 493 ("EASI")

This slender thread is not a reasonable basis on which to assert that EASI's contracts with the Plaintiffs are 'franchise agreements' for a number of reasons. First, the five day training program is a condition precedent to obtaining an EASI dealership [and not] ongoing assistance during the pendency of the agreement. [...] Second, the offer of assistance must relate to the business' method of operation. The five day training program, in substance, relates to learning about the products rather than learning about any particular method of operation. Third, the statute sets out six examples of what it means by "method of operation" – building design, furnishings, locations, business organization, marketing techniques and training. The first five are clearly inapplicable and the "training" offered does not, in its real substance, relate to method of operation. Finally, the result of the Plaintiff's submission, if correct, would be that any company selling a sophisticated product, and offering advance training about that product to its nascent distributors, would in law be a franchisor. It is unlikely the Legislature intended this result.<sup>13</sup>

By focusing its analysis of the sufficiency of the elements of control and assistance on: (i) control or assistance occurring "during the pendency of the agreement" and not as a condition precedent to the franchise grant, and (ii) control or assistance that relates to the businesses' method of operation, rather than to the products being sold, the Court has drawn two helpful distinctions that will assist practitioners to provide more certain advice to their clients with respect to the application of the Ontario *Act*.

#### B. Australia Law Discussion

1. Franchising is regulated by the Franchising Code of Conduct (the "Code"), which regulates parties to "franchise agreements". The Code governs certain conditions of the franchise agreement such as the sale of franchised businesses, termination, and dispute resolution. It does not govern commercial terms such as the amount of fees that will be charged, the level of support and the extent of assistance to be given, the length of the franchise agreement etc.
2. The Code requires franchisors to provide specific information to franchisees, namely:
  - (a) Disclosure documents to potential franchisees prior to their entry into a franchise or the renewal or extension of their franchise agreements, and to franchisees during the term of their agreements (upon request);
  - (b) Audited statements of any marketing or advertising funds run for the franchised business; and
  - (c) Copies of certain documents relating to the lease of premises by the franchisees.

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<sup>13</sup> Ibid., para 26-27

3. The definition of “franchise agreement” under the Code is broad and covers most arrangements involving the licensing of a name and operation of a business system. While some parties prefer to have a simple “license” or “distribution” agreement, one or more of the four elements listed below must be absent from such an arrangement for it to be outside the ambit of the Code:

(a) An agreement, which can be written, oral or implied. The agreement grants the right to carry on the business of offering, supplying or distributing goods or services in Australia under a system or marketing plan substantially determined, controlled or suggested by the franchisor or its associate;

(b) The business will be substantially or materially associated with a trademark, advertising or commercial symbol owned or specified by the franchisor or its associate;

(c) A requirement to pay a fee or other payment prior to or during the term of the agreement such as an initial capital investment fee, payment for goods or services, royalty fee or training fee; or

(d) The business must show that they have implemented a ‘system or marketing plan’.<sup>14</sup>

#### 4. Australia Case Law

It is relatively easy to tell whether the first three criteria have been satisfied by looking at the facts of the case. The contentious part of the definition is what constitutes a ‘system or marketing plan’. The Australian Courts have generally looked to American cases for guidance on how to define a ‘system or marketing plan’ and, as a result, there is little case law on this topic. However, the following two cases provide some guidance on how the Australian Court’s interpret the Code.

The Federal Court of Australia’s 2004 decision in *Capital Networks Pty Ltd v. au Domain Administration Ltd*.<sup>15</sup> considered the meaning of “franchise agreement” under the Code and set out a number of factors that are to be used when determining the existence of a ‘system or marketing plan’. These indicators include:

(a) *the provision by the franchisor of a detailed compensation and bonus structure for distributors selling its products;*

(b) a centralized bookkeeping and record keeping computer operation provided by the franchisor for distributors;

(c) a scheme prescribed by the franchisor under which a person could become a distributor, direct distributor, district director, regional director, or zone director;

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<sup>14</sup> See *ACCC v. Kylloe Pty Ltd.*, [2007] FCA 1552.

<sup>15</sup> [2004] FCA 808.

- (d) the reservation by the alleged franchisor of the right to screen and approve all promotional materials used by distributors;
- (e) a prohibition on re-packaging of products by distributors;
- (f) the provision of assistance by the alleged franchisor to its distributors in conducting ‘opportunity meetings’;
- (g) suggestion by the franchisor of the retail prices to be charged for products; and
- (h) a comprehensive advertising and promotional program developed by the alleged franchisor.

These helpful indicators were relied upon in *ACCC v. Kyofo Pty Ltd*.<sup>16</sup> The main issue in this case was whether or not a franchise agreement had been entered into inadvertently between two distribution companies. The Federal Court followed its previous decision in *Capital Networks Pty Ltd* and clarified the criteria set out in the Code, which determines when an agreement is considered to be a ‘franchise agreement’. While the Court found that there was no franchise agreement in this case, the decision provided a full discussion on the definition of a ‘system or marketing plan’ as previously explored and solidified the Court’s willingness to follow American jurisprudence.<sup>17</sup>

### C. Mexico Law Discussion

Mexican franchise law is governed and regulated by *Ley de la Propriedad Industrial*.<sup>18</sup> Pre-sale disclosure of information to prospective franchises is required, as is the filing of information about the franchisor and registration of the transmission of trademark rights to the franchisee. According to article 142 of the IPL a franchise exists, “*whenever, in conjunction with a license to use a trademark granted in writing, technical knowledge is transmitted or technical assistance is furnished in order to enable the licensee to produce or sell goods or render services in a uniform manner ...*”<sup>19</sup> There is no Mexican case law at this time.

### D. EU Law Discussion

In France courts have applied the *Loi Doubin* to leases of an entire business and to exclusive or quasi exclusive distribution contracts.

From other EU countries no case law is known where non-franchise contracts have been subjected to existing franchise laws. However, in Belgium legal counsels are aware of the risk, seen the vast possible interpretation of “commercial partnership”, that a considerable number of commercial relationships other than franchising may fall

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<sup>16</sup> Supra note 18.

<sup>17</sup> The above “Australia” discussion largely came from the article written by Anna Trist, “Is Your Business Arrangement a Franchise? *Legal Update: Franchising* (October 2008) online: [http://middletons.com.au/publications/newsletter\\_issue.asp?id=75&art\\_id=114](http://middletons.com.au/publications/newsletter_issue.asp?id=75&art_id=114).

<sup>18</sup> effective 27 June 1991 [“IPL”].

<sup>19</sup> Ibid.

under disclosure scope of the pre-contractual disclosure law. They advise to be cautious and to give the pre-contractual information required by the law when its different conditions are fulfilled.

#### **IV. Exemptions**

##### **A. Canadian Law**

There are certain limited exemptions from the disclosure requirements under the Ontario's *Wishart Act*. One such exemption is reserved for circumstances where a franchisee is selling or transferring his interest in the franchise to a purchaser, and aside from the franchisor consenting to the sale or transfer, the franchisor is otherwise not involved in the transaction. In such circumstances, the Act does not require the franchisor to provide the new purchaser with a disclosure statement.

Exemptions are also available if the franchisee's investment is less than \$5,000.00 or if the franchise agreement is for a period of less than one year and do not involve the payment of a non-refundable franchise fee. In addition, if the franchisee's investment in the franchise exceeds \$5,000,000.00 over one year, the disclosure requirement does not apply. Finally, there is a single-license exemption. Section 2(3)(5) of Ontario's *Wishart Act* states that the Act does not apply to "*an arrangement arising from an agreement between a licensor and a single licensee to license a specific trade-mark, service mark, trade name, logo or advertising or other commercial symbol where such license is the only one of its general nature and type to be granted by the licensor with respect to that trade-mark, service mark, trade name, logo or advertising or other commercial symbol*". The scope of this exemption has yet to be determined.

##### **B. Other Countries**

With respect to Australia, Brazil, France, Italy, Spain and Mexico, their respective franchise laws do not provide any exemptions or exceptions to the requirement to provide disclosure to prospective franchisees. All potential franchisees must be provided disclosure.

None of the existing laws in any of the EU countries provides explicitly exemptions from the application of the respective law to certain kinds or forms of franchise contracts.

It is to be mentioned that the UNIDROIT Model Franchise Disclosure Law provides in its Art. 5 a long list of exemptions; however, this model law has not been implemented.

#### **V. How to Avoid the Unintentional Franchise When Structuring Agreements**

Avoiding key elements in the definition of a franchise in the particular statute is the surest way to avoid having a franchise relationship being created by the agreement.

However, it should be kept in mind that many of these statutes specifically provide that the franchisee cannot waive their rights under the statute

A. No Common Trademark.

A crucial aspect of franchising legislation is the granting by a franchisor of the right to use its intellectual property. The trade-mark requirement will be satisfied if goods or services are “*substantially associated with the franchisor's, or the franchisor's associates, trade-mark, service mark, trade name, logo or advertising or other commercial symbol*”. There is no requirement that the collective intellectual property be formally assigned or licensed. Instead, there must only be some “substantial association” between the goods and services offered and the franchisor’s intellectual property.

B. No Significant Assistance or Control.

It is also a requirement that the franchisor or its associate must render “*significant control over or offer significant assistance in, the franchisee's method of operation, including building design and furnishings, locations, business organization, marketing techniques or training*”, as stated in ss. 1(1)(a)(ii) of the *Wishart Act*. Whether the assistance is “significant” enough to be caught by this subsection is a matter of fact. Also, note that the section requires only that assistance be offered, not actually provided. The determination of control will be made on a case-by-case basis. In light of the *de jure* standard of control adhered to in cases related to the *Income Tax Act (Canada)*, it is possible that the mere ability of the potential franchisor to exert a high degree of control over a franchisee could satisfy the requirements of the *Wishart Act*.

C. No Payment of Franchise Fee.

The Acts require nothing more than the franchisee being required “*to make a payment or continuing payments*”. There is no definition of “franchise fee” under the Acts. Therefore, any kind of payment may qualify. The requirement will be met whether such payments are made directly or indirectly to the franchisor or its associate, and either as a means to acquire the franchise or during its operation. With little judicial treatment of the fee requirement to determine its limits, and the vague wording utilized by the Acts to define what form of payment is necessary to qualify the franchisor/franchisee arrangement, the fee requirement may be easily met under a wide variety of possible scenarios.

## VI. Conclusion

Counsel must be very careful when advising a client with respect to agency, license, distribution and other forms of legal relationships. Such relationships may unintentionally create a franchise relationship. The result will be onerous disclosure and continuous disclosure obligations on the part of the unintentional franchisor, and provide



the unintentional franchisee with remedies that it may not necessarily have had otherwise.

## Authors

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