Taking Your Franchise to Canada

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1. INTRODUCTION

A) Why Canada?

In part due to its significant levels of natural resources, skilled labour force, and capital markets, Canada continues to be a stable and reliable economy in which to do business. Canada like the United States, is a geographically vast country with many different regions. Unlike the U.S. however, Canada's population (33,212,696)[1] is concentrated along the Canada-U.S. border, with almost 35% of the Canadian population, more than 9 million people, residing in the southern most part of Ontario, commonly referred to as the "Golden Horseshoe."[2]

Canada is a federal state comprised of ten provinces and three territories: British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec, New Brunswick, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, and the Yukon, Northwest Territories and Nunavut.

Interestingly, 86% of Canadians live in one of four provinces: Ontario, Québec, British Columbia or Alberta.[3] Ontario is the most heavily populated province and accounts for nearly 40% of Canada's population (12.7 million Ontarians) with a large majority of these individuals living in the Greater Toronto Area ("GTA").[4]

As a result of these geographic/demographic realities, a U.S. franchisor might find expanding to Canada is simply a matter of moving northward a few hundred miles.

B) Franchising Into Canada - Keeping It Simple

Some foreign franchisors choose to enter the Canadian market by incorporating a subsidiary, establishing business premises, hiring employees and franchising directly to unit franchisees. Others may franchise directly to Canadian unit franchisees from their non-Canadian head office, without having an establishment in Canada. The majority, however, choose the much simpler route of contracting with one or a few master franchisees or area developers and licensing them to expand the franchise system throughout Canada. This approach avoids a number of tougher issues such as employment laws, tax planning, corporate structuring, and filings. This paper will outline matters to be addressed in this simpler and most common method of expanding an international franchise system into Canada.

2. MASTER FRANCHISING AND AREA DEVELOPMENT ARRANGEMENTS

A) Master Franchising

Master franchising is often the approach taken by foreign franchisors in expanding to other jurisdictions. Master franchising has been employed in North America for years for the more rapid development of regions within the United States and Canada. Canada's close proximity to

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[1] Statistics Canada Canadian Demographics lit a Glance (91-003-XWE) (January 25, 2008); July, 2008, estimate.
[2] https ://www.cia.gov/library/publicalions/the-world-factbook/geos/ca.html.
[3] Statistics Canada - Canadian Demographics at a Glance (91-003-XWE) (January 25, 2008).
[4] *Ibid*

the massive U.S. market has resulted in a substantial volume of franchise traffic between the two countries. Very often the structure chosen is that of a master franchise.

The term "master franchising" is used to describe several different types of situations. Some of the more common characteristics of business arrangements that are typically regarded as master franchising include the following:

(a) The franchisor delegates one or more of its fundamental rights or responsibilities in the franchising process – for instance, the right to select and approve other franchisees to operate individual units ("unit franchisees") or the right to carry out all responsibilities of the franchisor – to another party (the "master franchisee").

(b) The arrangement may extend to a specified territory – for instance, a group of municipalities, a province or the entire country – within which a number of outlets are to be established.

(c) The master franchisee has some ongoing involvement with the operation of the outlets in the territory – for instance, the master franchisee may operate the outlets directly or be responsible for the supervision of the unit franchisees.

(d) The master franchisee has some continuing benefit derived from the operation of outlets in the territory – for instance, revenues earned from operations or sharing franchise fees/royalty payments with the franchisor.

B) Development Agreement and Subfranchising

While there are many different arrangements which qualify as master franchising, master franchisees can be divided into one of two broad categories; those that permit subfranchising and those that do not. In the latter case, the agreement used is often referred to as a "development agreement". When subfranchising is permitted, the agreement is by necessity more complex, though there are common provisions found in agreements in both situations. When subfranchising is permitted, matters become more complicated because there are three, rather than two, parties with a stake in the operation of the unit franchise.

3. PRINCIPAL AREAS OF LAW

A) Registering Trade Marks

One of the first things a U.S. franchisor should do is protect the system's trademarks in Canada by applying for registration under the federal Trade-marks Act.[5]

Top 10 Reasons Why U.S. Franchisors Should Register their Trademark[6]

(1) Registration can cost as little as $2,500.

[5] *Trade-marks Act*, R.S.C. 1985, c. T-13

[6] International Franchise Expansion: Trademark and Trade Secret Law by Ned Levitt (Toronto, Ontario, Canada), Shelagh Carnegie (Gowling Lafleur Henderson LLP), and Allan Hillman (Shipman and Goodwin, Hartford, Connecticut, USA).

(2) A registered trademark gives the owner the exclusive right to its use throughout Canada even though the registered owner has used it in only one location.

(3) A registration is good forever provided a nominal renewal fee is paid every 15 years and the trademark continues to be used.

(4) A registered trademark is a business prerequisite for expansion through licensed franchisees.

(5) In a legal proceeding for infringement of a registered trademark, the registered owner is deemed to have exclusive rights in the trademark and the onus is on the defendant to prove otherwise. This gives the owner of the registered trademark a significant tactical advantage.

(6) A registration is a defined right which can be asserted against others.

(7) As a definable right it will enhance the value of the business by more clearly defining goodwill as an asset.

(8) A registration is a property right which can be bought and sold like any other asset.

(9) The registration will be recorded in the Trade-marks Office. Confusingly similar applications will be denied by the Office without the owner's involvement and at no expense to the owner.

(10) Registration will serve as notice to others of the owner's rights thereby requiring or at least encouraging them to select non-confusing alternatives.

(i) ***Searching Trademarks***

Before an application for trademark registration is made, a thorough search of the trademarks register and business names register should be conducted to determine if the trademark could be confused with another previously registered mark or previously used trade name. These clearance searches are extremely important because they are a way of pre-screening the likelihood of successfully registering a trademark and using that mark without great risk of being subjected to a passing off or infringement action by another party with senior rights. As the entitlement to trademark registration and use in Canada is based upon first use in Canada, such a search may also reveal parties using a conflicting mark but with junior rights. Action can then be taken to stop this type of use.

(ii) ***Date of Filing***

If an application is not based on a foreign application filed within the previous 6 months, the date that the application is filed in Canada becomes the effective date for protection of the trademark owner's rights. It is recommended that as soon as a trademark is selected and cleared, an application for registration be filed.

(iii) ***The Trademark***

A clear copy of the word, design or combination mark must be submitted with the application. In cases such as colour claims, an accurate description of the trademark must also be provided.

(iv) ***The Associated Wares and Services***

A trademark applicant must set out the wares and services they intend to market and sell in association with the trademark.

Canada is highly unique in this aspect of trademark applications. In Canada, applicants must provide a list in specific, ordinary commercial terms of the wares and services that they intend to associate with their trademark. There is no class system.

(v) ***Basis for Application***

Some jurisdictions require that an applicant state the basis upon which they are claiming rights to the trademark. Such basis may include prior use of the mark, intent to use the mark, making known, or use and registration in a foreign country. In Canada, an applicant must claim one or more of these following four grounds in its application.

A) *Use in Canada*

"Use" in trademark law does not have the same meaning as in ordinary business language. What is essential is that the trademark be associated in the mind of the public with the goods or services produced or provided by the trademark owner. A trademark is deemed to be used in association with wares if, at the time of transfer of the goods, the trademark is marked on the goods themselves or on the containers or packages in which they are distributed or in any other manner so associated with the wares that notice of the association is given to the person to whom the property or possession is transferred.

With respect to services, a trademark is used if the trademark is used or displayed in the performance or advertising of those services.

The use must be continuous and in the ordinary course of trade but may be seasonal in accordance with the nature of the trade. As long as there is use of a trademark in the sense as described above, the issue of abandonment does not arise. Furthermore, the use must occur in Canada and does if any part of the chain of sale from the manufacturer to the consumer takes place in Canada.

The first person to use a trademark in Canada acquires the right to that trademark and is the person entitled to registration of the mark. Prior use by another of a confusing trademark or trade name will preclude or invalidate registration of a trademark. In applying to register a trademark that has been used in Canada, the date of first use must be set forth in the application. Where use is challenged in opposition proceedings or in Court, the owner has a duty to lead its best evidence as to the use of the trademark in Canada. Where a registration is challenged on the basis of prior use by another, the registered owner may lead evidence of use even prior to that alleged prior use.

B) *Making Known*

A person or entity may acquire rights in a trademark that has not been used in Canada if that trademark has been made known in Canada. The Canadian *Trade-marks Act* states that "[a] trademark is deemed to be made known in Canada by a person only if it is used by that person in a country of the Union[7] other than Canada, in association with wares or services, and the wares are distributed in association with it [the mark] in Canada, or the wares or services are advertised in association with it in [Canada] ..., and it has become well known in Canada by reason of the distribution or advertising." In order to successfully register a trademark on that basis, there are strict requirements.

C) *Foreign Applications/Registration And Use Abroad*

Under certain conditions and in adherence to Canada's obligations under the International Convention, if a trademark has been used and registered in a country of the Union other than Canada, the applicant may apply under the terms of the Convention[8] to seek registration of the trademark in Canada. The limiting conditions are that there has been no prior use, registration, or making known in Canada of a confusing trademark or trade name and that the trademark is otherwise registrable. For example, a U.S. trademark owner can seek to register its trademark in Canada solely on the basis of use of the mark and registration in the U.S.

Foreign applicants are entitled to register a trademark that would ordinarily be refused registration because it was a surname, or primarily descriptive or misdescriptive or the name of the wares or services if the trademark is not without a distinctive character. However, registration that is contrary to public order is prohibited. A mark that lacks inherent distinctiveness will also not be registered in Canada unless the mark is shown to have acquired distinctiveness in Canada.

The effective filing date of the Canadian application is the date of first filing in the Convention country if the applicant applies to register the trademark in Canada within six months of filing in the Convention country.

D) *Proposed Use*

Canadian trademark applications are permitted on the assertion that the mark is intended for use in Canada. The first person to file an application on proposed use acquires the right to that trademark (unless another party has made prior use), and is the person entitled to secure registration of the mark, once a declaration of use is filed stating that the mark has been used in Canada.

(vi) ***Other Trademark and Related Issues***

Where the franchisor operates or franchises in Canada through a separate corporation which is not the one owning the trademark, care must be taken under Canadian law to have in place a written inter-corporate trademark licensing agreement to demonstrate that the corporation

[7] Defined as any country that is a member of the Union for the Protection of Industrial Property constituted under the Convention [of the Union of Paris], or any WTO member.
[8] The Convention of the Union of Paris.

owning the trademarks maintains control over them, even where the Canadian use is by, or licensed by a subsidiary.

Because Canada has a separate country level domain name system, operating as .ca domain names, non-Canadian franchisors will often want to protect their domain names by acquiring registration of their .ca domain name equivalents. There are restrictions on who can hold a .ca domain name registration. Basically, a foreign franchisor would have to incorporate a Canadian company to hold the .ca domain name, unless the franchisor is also the owner of the equivalent Canadian trademark registration.

In Canada, copyrights can be registered quite easily and inexpensively. Of note, no deposit copies of the work need to be filed at the Copyright Office, and thus registrations are often obtained for confidential works such as operating manuals, because their confidentiality will not be compromised by public filing. Copyright registration can provide significant benefits if enforcement litigation should become necessary.

B) Tax Considerations

A traditional master franchise relationship between a U.S. franchisor and a Canadian entity, with the one exception described below, would not likely attract taxation under any of the Canadian or provincial taxing statutes.

(i) ***Withholding Tax & Royalties***

Canada imposes a withholding tax (an income tax on a non-resident of Canada) when a resident or a "deemed resident" of Canada pays or credits certain amounts to a non-resident of Canada. The tax is required to be withheld and remitted to the Canada Revenue Agency by the Canadian payor on behalf of the non-resident payee. Canadian withholding tax applies on payments of royalties, dividends, interest, and certain other items paid to a non-resident of Canada. What this typically means for a U.S. franchisor is that payments coming from the Canadian master franchisee will be automatically reduced by the amount of the withholding taxes.

The current withholding tax rate is 25% subject to a reduction to 10% if the recipient of the royalty is a resident of the United States for the purposes of the Canada-United States Convention with Respect to Taxes on Income and on Capital[9] ("Treaty") between the two countries. The Fifth Protocol to the Convention clarified Canada's position with respect to limited liability companies ("LLC"). The reduction to 10% extends to US-resident members of a LLC (and other fiscally transparent entities) to claim benefits under the Convention if:

(a) the person is considered under the tax law of the resident state to have derived the amount through an entity that is not a resident of the other contracting state and;

(b) by reason of such entity being treated as fiscally transparent under the tax law of the person's resident state, the tax treatment of the amount is the same as if it had been derived directly by that person.

[9] Canada-United States Convention with Respect to Taxes on Income and on Capital signed at Washington on September 26, 1980, as amended by the Protocols signed on June 14, 1983, March 28, 1984. March 17, 1995 and July 29, 1997. Available online: htlp://www.fin.gc.ca/treaties/USA_e.html.

Example: U.S. investors use an LLC to invest in Canada. The LLC – which Canada views as a corporation but is a flow-through vehicle in the U.S. – earns Canadian-source investment income. Provided the U.S. investors are taxed in the U.S. on the income in the same way as they would be if they had earned it directly, Canada will treat the income as having been paid to a U.S. resident. The reduced withholding tax rates provided in the tax treaty will apply.[10]

(ii) ***Foreign Tax Credits***

Withholding taxes that are deducted from royalties paid to the U.S. franchisor will usually be eligible for foreign tax credits against the U.S. taxes payable by the U.S. franchisor.

C) Franchise Disclosure Legislation

Currently, franchise specific legislation (containing primarily disclosure obligations) exists in the provinces of Alberta, Ontario, New Brunswick, Prince Edward Island and Manitoba. There is no similar federal legislation.

It is commonly believed by franchise lawyers in Canada that a non-Canadian franchisor needs to make disclosure to a master franchisee for the whole of Canada because the Ontario, New Brunswick, Prince Edward Island and Manitoba statutes take jurisdiction when the franchise is to be operated "partly or wholly" in the respective province. The same is true under the Alberta statute if the franchisee is resident or has a permanent establishment in Alberta. The master franchisee will in turn be required to make disclosure to its Canadian unit or area franchisees in the provinces with disclosure legislation, but the non-Canadian franchisor will not be required to make any further disclosure.

The disclosure requirements are triggered by the payment of any money to the franchisor or its affiliate or the signing of any agreement by a prospective franchisee relating to the franchise. Disclosure must be made at least 14 days before the triggering event.

All but the Ontario statute specifically permit the use of foreign franchise disclosure documents, provided there is an addendum which adds any additional information required under the relevant provincial statute. Ontario does not prohibit such "wrap-around" disclosure but many lawyers caution against using them because the Ontario statute requires the disclosure to be *clear and concise* as do the Prince Edward Island and Manitoba statutes, and, in Ontario, there are other more rigid requirements that relate to the form the disclosure document takes. Since it is very difficult to be clear and concise when the disclosure document contains non-relevant U.S. material, the prevailing practice is not to use U.S. disclosure documents in Canada. Additionally, the cost of conforming a "wrap-around" disclosure document often approximates the cost of doing a specific provincial franchise disclosure document from scratch.

With regard to U.S. or other non-Canadian financial statements, they must be prepared in accordance with generally accepted auditing or review engagement standards that are at least equivalent to those set out in the Canadian Institute of Chartered Accountants Handbook.[11] This

[10] Backgrounder: The Fifth Protocol to the Canada-United States Income Tax Convention. Department of Finance Canada. Available online: http://www.fin.gc.ca/news07/data/07-070_1e.html.
[11] GENERAL, O. Reg. 581/00, s.l l; Arthur Wishart Act (Franchise Disclosure), 2000, S.O. 2000, c. 3.

usually means that they need to be reviewed by a Canadian chartered accountant, who then prepares notes to the U.S. or other financial statements, which will allow them to meet the Canadian standards.

Where the franchisor for Canada is a separate corporation, it will be that corporation's financial statements which must be attached to the disclosure document. All of the Canadian franchise statutes require attachment of the financial statements "of the franchisor". Thus, consolidated financial statements should not be used.

A more detailed discussion of Canadian franchise legislation follows in Section 4(a) below.

D) Uniqueness of Québec

In many ways (socially, culturally and linguistically) the province of Québec is a distinct society within Canada.

With the exception of Québec, the Canadian legal system is based on the common law tradition of the United Kingdom. Common law principles in Canada, such as those found in the law of tort, contract or property (both real and personal) are quite similar to those of the United States. The Québec legal system, however, evolved from French civil law. In Québec, the civil law system applies to private law matters. Thus, to the extent Québec is empowered by the Canadian Constitution to make laws, Québec uses a civil code – the Civil Code of Québec ("CCQ").[12]

U.S. franchisors should be aware of some additional restrictions encountered under Québec law that, although not specifically dealing with franchising, nevertheless have an impact upon franchising activity in that province. The duty of good faith and fair dealing is enshrined in the CCQ[13], and applies also to pre-contractual negotiations. The Code also sets forth a series of rules, founded upon an implicit pre-contractual disclosure obligation, governing certain types of provisions contained in adhesion contracts (contracts not subject to negotiations), such as external (collateral), abusive, illegible and incomprehensible provisions. These specific disclosure obligations are unilateral and imposed on the stipulating party in order to ensure that the adhering party has knowledge of and has consented to all of the provisions in the contract. Furthermore, the burden of proof of such knowledge and consent is placed upon the stipulating party.

Provisions which are illegible or incomprehensible to a reasonable person are null if the adhering party suffers resulting damage and the other party cannot prove that it gave an adequate explanation of the provision.[14] External clauses in contracts of adhesion, which refer to and incorporate provisions not expressly included in the contract itself or its schedules, are null if, at the time of contract formation, the provision was not adequately brought to the adhering party's attention, or if this party was not, or could not have been, aware of the provision.[15] The Franchisor's operating manuals would be considered external clauses, and thus require special treatment when signing Québec franchise agreements.

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[12] *Civil Code of Québec, C.c.Q. [CCQ]*.
[13] *CCQ, Articles* 6, 7, 1375
[14] *CCQ, Article 1436.*
[15] *CCQ, Article 1435*

Abusive clauses are clauses in a contract that are considered unreasonably detrimental to the adhering party and are therefore not in good faith. In Québec, these clauses are either considered null and void, or the obligation arising from them may be reduced.[16] An example of an abusive clause would be one which so departs from the fundamental obligations arising from the rules normally governing the contract that it changes the nature of the contract.

Franchisors in Québec are not required to provide a disclosure document. If a franchisor does provide it, a franchisee may allege that the franchisor is bound by all of the representations contained in it. That argument will be even stronger where the franchisor has signed the disclosure document with the standard form of certification which is required under the franchising statutes in the other provinces.

Given that the majority of the population of Québec speaks French as a first language, it is also important to take note of certain key sections of the province's *Charter of the French Language* ("Charter").[17] The use and imposition by franchisors of lengthy pre-printed franchise agreements are viewed in Québec as contracts which, according to the Charter, would need to be drafted in the French language (unless the parties contract in writing otherwise). The Charter also deals with issues relating to advertising, computer software, consumer rights, employment matters and commercial signage, stipulating that all documentation addressed to the public or to the franchise's employees must be in French first and must be displayed equally or more prominently than any other language used. This would also apply to trademarks and company names. However, if a company has an English name or mark only, that name or mark may be used alone.[18]

For those franchisors who are also suppliers of pre-packaged products, the federal packaging and labelling legislation requires franchisors to produce their products with labels in both English and French, not only in Québec, but throughout all jurisdictions of Canada.[19]

E) Competition Law

Significant recent amendments to the federal *Competition Act*[20] are of particular interest to franchisors. Prior to the amendments, it was a criminal offence to influence upward, or discourage the reduction of, the price at which a person supplied, offered to supply or advertised a product within Canada. Franchise agreements typically have been drafted to provide that a franchisor would only make recommendations or suggestions with respect to pricing with which the franchisee would not be obliged to comply.

The amendments to the *Competition Act* effectively decriminalize price maintenance. It is now a civil reviewable practice that is presumptively lawful until proven to have an adverse effect on competition. This change should allow for greater harmonization of a foreign franchisor's pricing policies. The available remedies for price maintenance include a cease and desist order or an order to supply on normal trade terms.

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[16] *CCQ, Article 1437*
[17] Québec *Charter of the French Language*, R.S.Q., c. C-11 ["*Charter*"]
[18] Levitt. N. and Mondragon D., J., "A Survey of International Legal Traps and How to Avoid Them Beyond the Franchise Laws", American Bar Association 30th Annual Forum on Franchising (2007) at 43.
[19] *Consumer Packaging and Labelling Act*, S.C. 1999, c.2.
[20] *Competition Act*, R.S., 1985, c. C-34.

F) Supply Chain Issues

Where the foreign franchisor is also a supplier to the system in Canada, there are a number of legal considerations of which to take note.

Regulatory barriers to moving goods across the border into Canada can be grouped into three main categories: import restrictions, import duties and technical standards.

Import restrictions under the *Export and Import Permits Act*[21] require that some goods may be imported only if the importer obtains the appropriate permit. These permits are part of a quota system which is intended to protect certain Canadian industries by limiting the quantity of goods imported into Canada each year. Additionally, there are many federal statutes which restrict the importation of a large variety of items including meat, plants, seeds, fruits and vegetables, magazines and books, drugs, and others.

Import duties are the time honoured method of protecting domestic businesses, by imposing a charge at the border which affects the competitiveness of imported products. Usually, the magnitude of the duty or tariff is influenced by the relative strength or weakness of any existing domestic industry.

Lastly, technical standards can be used to protect local industries by applying technical standards which can be complied with more easily or cost effectively by domestic manufacturers. These standards are set by many levels of government and as well by influential private organizations such as the Canadian Standards Association in Canada.

G) Food and Beverage Issues

Many franchises systems operate in the food sector. There are several important food and beverage considerations, such as food safety, awareness of food allergies and related liability and insurance issues of which franchisors coming to Canada should be aware.

(i) ***Food Safety***

Food safety issues are of primary concern for franchisors. There are many different considerations that must be addressed, ranging from how to deal with recalled foods, food management after a power failure, food irradiation, issues surrounding the deep frying of foods and those related to infectious food-borne diseases such as Hepatitis A.[22]

The issue of food allergies is perhaps one of the most significant concerns for restaurant operators today. The problem of food allergies has been increasingly well publicized as a result of deaths linked to hypersensitive reactions produced by everyday foods. These deaths have occurred in all kinds of situations where Canadians eat food, but particular attention has been focused on restaurants and other foodservice establishments. Therefore, it is important for restaurant operators to be aware of what causes allergic reactions and how they may be identified and treated within the restaurant setting. To that end, one of the biggest challenges facing

[21] *Export and Import Permits Act*, R.S.C. 1985, c. E-19.
[22] "Food Allergies and the Foodservice Industry", online: Canadian Restaurant and Foodservices Association <www.crfa.ca> [CRFA].

restaurant operators is how to provide accurate ingredient information to customers with food allergies so that adverse reactions to food products may be avoided.

(ii) Food Service Establishment Licensing

In addition to the required liquor licenses and anti-smoking laws, outlined below, and any other relevant municipal requirements, foodservice establishments must also remain in compliance with the many health and sanitary requirements of various provincial statutes such as the *Health Protection and Promotion Act*.[23]

(iii) Liquor Licensing

Alcohol is regulated in Canada at the provincial level and is overseen by the respective provincial commissions responsible for such matters. In Ontario, the Alcohol and Gaming Commission of Ontario oversees the implementation of such pieces of legislation as the *Alcohol and Gaming Regulation and Public Protection Act* and the *Liquor License Act.*[24]

These laws provide practical rules for the responsible sale and service of beverage alcohol in that province. The legislation and its regulations provide the Registrar of Alcohol and Gaming with the authority to regulate and license: liquor sales licenses, liquor delivery service, manufacturer's licenses and representative licenses. Those operating bars, restaurants, hotels, clubs and taverns must register and obtain a liquor license if they intend to serve beverage alcohol. There is also an obligation upon new liquor sales license holders and others, under the *Liquor Licence Act* Regulations, to conduct the "Smart Serve" training program for the benefit of their employed servers. This program, which was developed by Smart Serve Ontario, a division of the Hospitality Industry Training Organization of Ontario (HITOO) teaches servers to prevent alcohol-related problems and shows them how to intervene should problems arise.

(iv) Anti-Smoking Laws

Canada is considered to be among those countries at the forefront of anti-smoking legislation. Public smoking is regulated at the provincial level and currently almost all provinces and territories have legislation and local by-laws enacted which ban smoking in public places. Public spaces include the workplace, restaurants and bars.

Across the country, various anti-smoking laws have been implemented, some of which are worth noting within the context of hotel and restaurant operation. In Ontario, as of 2006, the *Smoke-Free Ontario Act* prohibits smoking in all workplaces and enclosed spaces open to the public, except for private homes and hotel rooms.[25] In Toronto, all bars and casinos, among other spaces, are smoke-free, with hefty fines for non-compliance. As of 2008, all retail behind-the-counter displays of tobacco are banned. In British Columbia, a province-wide ban on smoking in public places took effect in 2008. In Alberta, smoking is prohibited in public places and workplaces where minors are allowed. In Manitoba, the *Non-Smokers' Health Protection Act* bans smoking in public areas, with the exception of hotel rooms, and restaurants and bars cannot

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[23] *Health Protection and Promotion Act*, R.S.O. 1990, c. H.7.
[24] *Alcohol and Gaming Regulation and Public Protection Act*, S.O. 1996, c.26; *Gaming Control Act*, S.O. 1992. c.24.
[25] *Smoke-Free Ontario Act*, S.O. 1994, c. 10.

have smoking sections or glassed-in smoking areas.[26] In Québec, smoking is banned in all public places, including restaurants, bars and casinos. In the Atlantic provinces, smoking in public places is also banned, with certain exceptions for specially ventilated rooms in the evening, and certain places where minors are not allowed.

(v) Business Insurance

Insurance is a valuable risk-financing tool in the restaurant business. Few organizations have the reserves or funds necessary to take on the risk themselves and pay the total costs following a loss. Purchasing insurance, although not risk management in itself, is part of a thorough and thoughtful risk management plan reflecting a commitment to prevent harm to both guest/patron and employee.[27] Some types of insurance are particularly relevant, including fire insurance, liability insurance, burglary protection and dishonesty insurance, the latter two forms covering theft by consumers and employees respectively.[28]

4. FRANCHISE SPECIFIC LEGISLATION

A) Some of the Similarities Amongst Canada's Franchise Statutes

- The definition of "Franchise" under Alberta's *Franchises Act*[29], *Ontario's, Arthur Wishart Act*[30], Prince Edward Island's *Franchises Act*[31], New Brunswick's *Franchises Act*[32] and Manitoba's *Franchises Act*[33] are quite similar. There are no exemptions for industry sectors, although the larger, more sophisticated franchisor, can be exempt under all of the statutes from providing financial disclosure. The definitions of "Franchise" involve concepts of the grant of a right to engage in a business, in association with the franchisor's trademark, in accordance with a marketing or business plan. The payment of an initial fee and continuing financial obligations on the part of the franchisee to the franchisor are important components of the definitions as well. Franchisor controls or assistance are also components of the Ontario, Prince Edward Island, New Brunswick, and Manitoba definitions.

- All material facts must be set out in the disclosure document. This extends beyond the specific items which the regulations to each statute require be disclosed and represents a different standard of disclosure than what a U.S. franchisor would be familiar with.

- A disclosure document is required to be delivered to the prospective franchisee. It must contain the statutorily required information about the system, the agreements to be signed, the franchisor and its directors and officers.

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[26] *Non-Smokers' Health Protection Act*, C.C.S.M., c. N92.
[27] "Controlling Costs with Risk Management", online: Insurance Bureau of Canada <www.ibc.ca>.
[28] "How to Start a Restaurant or Catering Business in Ontario", online: Canada Business (Government of Canada) <www.canadabusiness.ca>,
[29] *Franchises Act*, R.S.A. 2000, c. F-23.
[30] *Arthur Wishart Act* (*Franchise Disclosure*), 2000, S.O. 2000, c. 3
[31] *Franchises Act*, R.S.P.E.I. 1988, c. F-14.1.
[32] *Franchises Act*, SNB 2007, c F-23.5.
[33] *The Franchises Act*, CCSM c F156.

- The disclosure requirements are triggered upon the payment of any money (even a deposit, except in Alberta, under certain circumstances) or the signing of any agreement relating to the franchise. Disclosure must be made at least 14 days before the triggering event.

- If no disclosure is made, the remedy of rescission is available for 2 years. If a disclosure document is delivered late or a defective disclosure document is delivered, then the franchisee has only 60 days to rescind the contract. In both instances franchisees have a right of action against the franchisor and the franchisor's associate (defined, but essentially an involved affiliate) for complete reimbursement of all money invested by the franchisee and for compensation for any net losses incurred. If the franchisor makes a disclosure but fails to disclose a material fact or makes a material misrepresentation, the franchisee also has a right of action against the franchisor and all persons who signed the document for damages.

- Earnings projections are not a required component of the disclosure document in any province, but all the Acts have requirements to be complied with, if earnings projections are given.

- Information about directors and officers and their backgrounds must be disclosed.

- There are no filing or registration requirements for disclosure documents.

- There are no post-grant relationship provisions, except freedom for franchisees to associate without franchisor interference, and an implied covenant of fair dealing in all franchise agreements.

- The Acts all contain a fractional franchise exemption substantially similar to those with which a U.S. franchisor would be familiar.

- Each of the Acts provides that, for claims enforceable under the statute, only the laws of that province apply and only the Courts of that province have jurisdiction. Clauses to the contrary in a franchise agreement are deemed void

B) <u>Some of the Distinctive Elements Among Canada's Franchise Statutes</u>

- Confidentiality agreements are specifically allowed in Alberta and Prince Edward Island, without prior disclosure.

- Only the Prince Edward Island Act and the Manitoba Act require the franchisor to disclose information about existing franchisees in some other provinces; however, information about other franchisees who are "geographically closest" is required in Ontario and Alberta if there are less than 20 franchisees in the province.

- Prince Edward Island, Alberta, New Brunswick and Manitoba require the franchisor to disclose information about former franchisees in other provinces under certain circumstances.

- Alberta's Act applies only in respect of franchises which are operated at least partly within Alberta and where the franchisee is an "Alberta resident" or is an entity with a "permanent establishment" in Alberta.

- The Prince Edward Island Act, the New Brunswick Act and the Manitoba Act are the only provincial statutes which permit delivery of disclosure documents via e-mail. Multiple conditions attach to this option however:

    - The sender has to ensure that the disclosure document is delivered in a single document or file, has only the content that is required, has no links to or from external documents or content, is delivered in a form that provides the reader with the option to store, retrieve and print the document, adheres to the content and format requirements of law; and

    - The franchisor must keep records of the electronic delivery and the prospective franchisee is to provide a written acknowledgement of receipt.

- A "substantially completed" disclosure document is not compliant with the Ontario Act. It is acceptable, however, under the Prince Edward Island Act, the Manitoba Act and the Alberta Act.

- In Alberta and Prince Edward Island, only information about directors and officers who will have day to day management responsibilities relating to the franchise must be disclosed.

- The Prince Edward Island Act does not exempt concession arrangements, as does the Ontario Act (the Act does not apply) and the Alberta Act (the disclosure requirements of the Act do not apply).

- The Prince Edward Island Act makes it more difficult for a franchisor to obtain an exemption from disclosure for a term no greater than one year than is the case under the Ontario Act. The Prince Edward Island Act states that not only must the franchise term be for less than one year and cannot involve the payment of a non-refundable fee, but also, the franchisor or its associate must provide location assistance to the franchisee, including securing retail outlets or accounts for the goods or services to be sold, offered for sale or distributed or securing locations or sites for vending machines, display racks or other product sales displays used by the franchisee. The New Brunswick and Manitoba Acts have language similar to the Prince Edward Island Act.

- The Alberta, Prince Edward Island, New Brunswick and Manitoba Acts exempt the purchase and sale of a reasonable amount of goods and/or services at a reasonable wholesale price from application of the Act. The Ontario Act does not contain this exemption.

- The Ontario and New Brunswick Acts require specific disclosure of all permits and licences a franchisee would require to operate the franchise business. Neither the Prince Edward Island Act nor the Alberta Act has this requirement.

- The definition sections in the New Brunswick, Prince Edward Island, and Manitoba Act expand on the definition of "franchisor's broker" over Ontario's definition. In Ontario the act defines "franchisor's broker" only in relation to a right to damages in favour of a franchisee who suffers a loss by reason of a misrepresentation to which a "franchisor's broker" is a party.

- New Brunswick is the first province to provide for a comprehensive dispute resolution mechanism in its franchise statute. It requires parties to attempt to settle disputes within 15 days after delivery of notice and if the parties fail to resolve the dispute within 30 days after notice the Act provides that any of the parties may deliver a notice to mediate the dispute.

- The Manitoba Act permits the delivery of a disclosure document as more than one document. The statute provides that if the disclosure document is not delivered as one document, the timing requirements for delivery of the disclosure document are not met until the date of the delivery of the last document. The other acts require the disclosure document to be delivered as one document at one time.

5. OTHER CONSIDERATIONS

Having chosen the simplest approach for it to expand the U.S. franchise system into Canada, matters get more complicated if the U.S. franchisor needs to exercise the right, which is common to master and area development franchise agreements, to take over the operation of the master or area development franchisee upon termination of the agreement.

A) Investment Canada Act

The establishment and acquisition of Canadian businesses by non-Canadians is regulated at the federal level under the *Investment Canada Act* ("ICA").[34] A person who is neither a Canadian citizen nor a permanent resident of Canada, and any entity that is controlled or beneficially owned by non-Canadians, are considered non-Canadian investors under the ICA. The stated purpose of the ICA is to encourage investment in Canada by Canadians and non-Canadians which contributes to economic growth and employment opportunities. Two federal government departments – Industry Canada and Heritage Canada – administer the ICA.[35]

The establishment of any new Canadian business, and most acquisitions of existing Canadian businesses by non-Canadians above certain monetary thresholds (see below) are subject to a mandatory notification procedure.[36] This notice must be given within 30 days after closing of the transaction.

Three types of investments are subject to full review and government approval before completion: (a) the direct acquisition of control (by way of acquisition of shares or assets) of a Canadian business with gross assets of $5 million or more; (b) the indirect acquisition of control of a Canadian business (through the acquisition of its parent company outside Canada) with

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[34] *Investment Canada Act*, R.S.C. 1985. c. 28.
[35] Lissoir, L, Pamenter, D. and Shore, J. "Establishing a Business in Canada" at 1, online: Gowling Lafleur Henderson LLP <www.gowlings.corn/dbic/index.asp>.
[36] *Ibid.*

gross assets of $50 million or more, or $5 million or more if the Canadian business represents over 50% of the assets of the foreign parent company being acquired; and (c) the acquisition of an existing business, or the establishment of a new or related business, in a culturally sensitive sector such as publishing, film and music, regardless of its size.[37] Much higher thresholds apply to investors from World Trade Organization ("WTO") countries, or who acquire control from WTO investors. The U.S. is a WTO country.

B) Taxes

Where the Canadian franchisee is in breach of its obligations under the franchise agreement and the U.S. franchisor exercises its right under the franchise agreement to "take over" the Canadian franchisee operations, it may become unavoidable for the U.S. franchisor not to have a permanent establishment in Canada. While a permanent establishment is maintained, the U.S. franchisor must pay Canadian income taxes on that portion of its income earned through the Canadian operations. This can lead to an accounting nightmare as world income will likely have to be reported, and the extent that the U.S.-based officers or employees devote a portion of the time during the year to the carrying on of the Canadian business, a portion of their salaries as well as common overhead must be allocated to the "Canadian side" of the books. One solution would be to incorporate a Canadian subsidiary to immediately acquire the franchisee's assets after termination.

(i) ***Goods and Services Tax ("GST")***

Non-residents carrying on business in Canada or receiving income from commercial real property located in Canada must register with (and provide security to) the Canada Revenue Agency ("CRA") for GST purposes, as well as collect and remit GST on taxable supplies made in Canada.[38]

GST is a federal value-added tax that applies to most supplies of property and services made in Canada.

GST generally applies to most goods and services at a rate of 5% on the consideration paid or payable for the "taxable supplies", except for certain taxable supplies that are considered to be "zero-rated" to which GST applies at a rate of 0%. Zero-rated supplies include basic groceries, prescription drugs, exported goods, certain services supplied to non-residents, as well as international freight and passenger transportation services.

GST is a fully recoverable tax for most corporations engaged in making taxable supplies, such that the actual cost of GST is ultimately borne by the end consumer. Corporations may claim "input tax credits" for GST that the corporation is required to pay on inputs of property or services acquired or imported for consumption or use in the commercial activity of the business.[39]

[37] *Ibid*
[38] *Ibid*
[39] *Ibid*.

(ii) ***Provincial Sales Tax ("PST")***

British Columbia, Saskatchewan, Manitoba, Québec and Prince Edward Island each impose a distinct PST similar to state sales and use taxes in the United States. The general rates of PST are 5% in Saskatchewan, 7% in Manitoba and British Columbia, 7.5% in Québec and 10% in Prince Edward Island but can vary for certain supplies such as motor vehicles and alcohol. PST in Québec and Prince Edward Island generally applies to the sale price plus GST.[40]

Except for real property, buildings and fixtures, supplies of tangible personal property are generally subject to PST. This includes furniture, equipment and other chattels. PST also applies to a limited range of taxable services which varies from province to province. Each province also provides for different exemptions from tax, though all provinces have a general exemption for goods purchased for resale purposes.[41]

(iii) ***Harmonized Sales Tax ("HST")***

The provinces of Ontario, New Brunswick, Nova Scotia and Newfoundland & Labrador combine their respective provincial taxes of 8% with the GST of 5% to form the HST which is imposed as a single tax at a rate of 13%.[42]

C) Director Residency Issues

Foreign investors need to be mindful of residency requirements. The *Canada Business Corporations Act* ("CBCA") requires that 25% of the directors of federal corporations be resident in Canada. In the case where there are fewer than four directors, the CBCA requires that one director be resident in Canada.[43] Each province has different residency requirements and an investor wishing to incorporate in Canada will have to consider this issue.[44]

In keeping with the CBCA, and the business corporations statutes of the Provinces of Alberta, Saskatchewan, Manitoba and Newfoundland, the Ontario *Business Corporations Act* ("OBCA") was recently amended to reduce the board residency requirement for directors to 25%.[45] Accordingly, at least 25% of the directors of an Ontario corporation, other than a non-resident corporation must be resident Canadians. Where the OBCA corporation has fewer than 4 directors, at least one must be a resident Canadian. By contrast, the business corporations statutes of the Provinces of British Columbia, Québec, New Brunswick, Nova Scotia, Prince Edward Island, as well as Yukon, Northwest Territories and Nunavut, do not impose residency requirements for directors.

D) Privacy Laws (PIPEDA)

Privacy laws regulating the collection, use and disclosure of personal information by governments and the public sector have been in place in Canada since the early 1980s – the federal *Privacy Act* and the companion freedom of information legislation, the *Access to*

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[40] *Ibid*.
[41] *Ibid.*
[42] *Ibid*.
[43] *Canada Business Corporations Act*, R.S.C. 1985, c. C-44.
[44] Lissoir, Pamenter and Shore at 5.
[45] *Business Corporations Act*, R.S.O. 1990, c. B.16.

Information Act – are overseen by the Privacy Commissioner of Canada.[46] As of 2006, Canadian business and private sector organizations are also now subject to federal or provincial privacy protection legislation governing both customer and, with some exceptions, employee information.

In 2001, the federal government enacted the *Personal Information Protection and Electronic Documents Act* (Canada) ("PIPEDA").[47] Different from U.S. privacy laws, PIPEDA closely resembles the provisions of the European Union's Data Protection Directive and brings Canada's privacy laws in line with an emerging international standard for the protection of personal information. PIPEDA applies to federally regulated private sector organizations and to other private sector organizations in provinces that have not enacted "substantially similar" legislation. It applies to personal and health information that is reasonably collected, used or disclosed in the course of commercial activity that takes place across the Canadian border, between provinces, and within a province that has not enacted "substantially similar" legislation – currently all provinces and territories except Alberta, British Columbia, Québec and Ontario.

PIPEDA establishes a comprehensive set of national rules governing the use of individual personal information, whether or not in electronic form, by the private-sector in the course of commercial activity in Canada. The cornerstone of PIPEDA is informed consent. The legislation requires that organizations obtain the informed consent of an individual before collecting, using or disclosing in the course of commercial activity any personal information relating to such individual. PIPEDA requires organizations to appoint a privacy officer to represent the organization in all privacy matters. PIPEDA also provides individuals with the right to access and have corrected any personal information pertaining to them and codifies remedies in the event of a violation of its privacy provisions.[48]

It is important to note that PIPEDA does not apply to businesses in relation to their employees, unless the businesses are federal works, undertakings or businesses. However, privacy legislation in British Columbia, Alberta and Québec does apply to employee information such that employers in those provinces must comply with the provincial legislation concerning both customers and employees.

PIPEDA applies when personal information is disclosed across a provincial border in the course of commercial activity and will apply in most situations where an organization in Canada receives or transmits personal information from or to a destination outside Canada. PIPEDA applies to the personal information of non-residents if an organization in Canada that is subject to PIPEDA collects, uses or discloses such information.

Essentially what all of this means for organizations doing business in Canada is that there are certain procedures which they must implement and follow in order to comply with Canadian federal and/or provincial privacy laws.[49] These laws impact how organizations collect, use and disclose an individual's personal information in the course of their business activities by compelling them to put systems in place reflecting the following privacy policies:

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[46] *Privacy Act*, R.S. 1985, c. P-21; *Access to Information Act*, R.S. 1985, c. A-I.
[47] *Personal Information Protection and Electronic Documents Act* (Canada) ("PIPEDA") (2000), c.5.
[48] Lissoir, Pamenter and Shore at 56.
[49] Siegel, A., "New Canadian Privacy Requirements for the Private Sector."

(a) **Accountability:** An organization is responsible for personal information under its control and shall designate an individual or individuals who is/are accountable for the organization's compliance with the following principles.

(b) **Identifying Purposes**: The purposes for which personal information is collected shall be identified by the organization at or before the time the information is collected.

(c) **Consent**: The knowledge and consent of the individual are required for the collection, use, or disclosure of personal information, except where inappropriate.

(d) **Limiting Collection**: The collection of personal information shall be limited to that which is necessary for the purposes identified by the organization. Information shall be collected by fair and lawful means.

(e) **Limiting Use, Disclosure, and Retention:** Personal information shall not be used or disclosed for purposes other than those for which it was collected, except with the consent of the individual or as required by the law. Personal information shall be retained only as long as necessary for fulfillment of those purposes.

(f) **Accuracy**: Personal information shall be accurate, complete, and up-to-date as is necessary for the purposes for which it is to be used.

(g) **Safeguards:** Personal information shall be protected by security safeguards appropriate to the sensitivity of the information.

(h) **Openness:** An organization shall make readily available to individuals specific information about its policies and practices relating to the management of personal information.

(i) **Individual Access:** Upon request, an individual shall be informed of the existence, use, and disclosure of his or her personal information and shall be given access to that information. An individual shall be able to challenge the accuracy and completeness of the information and have it amended as appropriate.

(j) **Challenging Compliance**: An individual shall be able to address a challenge concerning compliance with the above principles to the designated individual or individuals for the organization's compliance.[50]

The Privacy Commissioner has the authority to investigate complaints regarding the alleged non-compliance of any organization with privacy legislation. Following an investigation, the Commissioner may make public any information relating to an organization's personal information management practices (if it is in the public interest to do so). Furthermore, the Commissioner or the complainant may apply to the Federal Court for various types of relief,

[50] *Ibid*

including an award of damages and/or an order compelling the organization to correct its practices.[51]

E) Temporary Entry for Business Purposes

The North American Free Trade Agreement ("NAFTA") is the primary means of entry into Canada of citizens from the United States. NAFTA applies to certain U.S. and Mexican citizens who are "business persons", a term defined as "individuals engaged in the trade of goods or services or in investment activities."[52]

Typically, a U.S. franchisor would enter Canada as a business visitor and would be allowed to stay for up to six months without a special visa. Anything longer or attempting to procure a work permit from Citizenship and Immigration Canada would significantly complicate the matter.

The four broad categories under NAFTA include business visitors, intra-company transfers, professionals and traders/investors. Business visitors must be based and primarily remunerated outside of Canada, and include those involved in (i) research and design; (ii) growth, manufacture and production; (iii) marketing; (iv) sales; (v) distribution; (vi) after-sales service; and (vii) general service.[53]

F) Labour and Employment Laws

In Canada, labour and employment laws are provincially regulated. They are not consistent among the various provinces.

In Québec, the French language is the required designated language of the workplace, and all workers are entitled to have access to required materials in French. This extends to computer software.

G) Advertising Laws

Canada's advertising laws are quite unique and differ substantially in some areas from the laws of the U.S. Specifically, care is needed regarding comparative advertising, and with respect to contests, which are highly regulated.

H) Provincial Corporate Registrations

Where a corporation is doing business in a province other than its province of incorporation, most provincial corporate laws will require that corporation to become corporately registered and to make annual information filings in that province. This is often referred to as "extra-provincial" registration. These requirements vary from province to province as do the definitions and jurisprudence surrounding what constitutes "doing business" in each province. Foreign franchisors franchising in Canada will need to pay attention to these specific requirements.

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[51] *Ibid*

[52] Available online: *http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/texte/index.aspx?lang=en&menu_id=34&menu=R.*

[53] Designated Profession List for TN Status, Appendix 1603.D.1 of Annex 1603 of the NAFTA

6. CONCLUSION

Canada is close, familiar and friendly and should be considered by most U.S. franchisors as being a relatively easy jurisdiction in which to Franchise. The rule of law applies, the judiciary is independent and has a good reputation as being fair, balanced and neutral.

Canada is, however a separate country with its own law. So, it is important for U.S. Franchisors to not only comply with franchise disclosure laws in Canada but also to conform their franchise agreements and other standard form agreements, manuals and other documentation to comply with Canadian laws and terminology.