UNIFORM LAW CONFERENCE OF CANADA

CIVIL SECTION

UNIFORM FRANCHISES ACT
REPORT OF THE WORKING GROUP

St. John's, Newfoundland and Labrador
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Uniform Law Conference of Canada (ULCC) - Commercial Law Strategy
Uniform Franchises Act Working Group Report – March 2005

1. Overview of Activities

[1] The Committee has proceeded following the ULCC August 2004 meeting to complete its project by preparing a final draft Uniform Franchises Act (the "Act") and draft regulations (the "Regulations") to the Act as directed by the resolution of the ULCC.

[2] The Committee continued its review of franchise legislation, including the regulations under such legislation, currently in force in the provinces of Alberta and Ontario, the Model Franchise Disclosure Law adopted by UNIDROIT, the current Federal Trade Commission Franchise Disclosure Rule in the United States, and proposed amendments to the FTC Rule. The basic approach of the Committee has been to consider the Ontario legislation as a working model, comparing it with the Alberta legislation, and inserting changes and modifications considered appropriate for clarity, exclusionary and consistency purposes.

[3] The Committee composition consisted of Co-chairs John Sotos, Sotos Associates LLP (Toronto, Ontario) and Frank Zaid, Osler, Hoskin & Harcourt LLP (Toronto, Ontario); ULCC National Co-ordinator Tony Hoffmann (Montreal, Quebec); François Alepin, Alepin Gauthier s.e.n.c. (Laval, Quebec) DN; Richard Cunningham, President, Canadian Franchise Association (Mississauga, Ontario); James Lockyer, Professor, University of Moncton (Moncton, New Brunswick); Len Polsky, Gowlings (Vancouver, British Columbia); Bruce Macallum, British Columbia Ministry of the Attorney General (Victoria, British Columbia); Tim Rattenbury, New Brunswick Department of Justice and Attorney General (Fredericton, New Brunswick); and Dan Zalmanowitz, Witten LLP (Edmonton, Alberta), Susan Klein, Legislative Counsel, Ministry of the Attorney General, continued to provide invaluable assistance in finalizing the Act, and in preparing various drafts, including the final draft, of the Regulations. Abi Lewis, Counsel, Policy Branch, continued to provide policy advice to the project. The Committee sincerely acknowledges their contribution, and also acknowledges with thanks the contribution of ULCC member John Twohig of the Ontario Ministry of the Attorney General, in arranging for their availability, as well as arranging for the French translation of the Act and the Regulations.

2. Activities During the 2004-2005 Year

[4] The Committee held a number of meetings by conference telephone and one two-day in-person meeting during the 2004-2005 year. The two-day in-person

meeting was held on September 19-20, 2004, at the University of Moncton Law School, Moncton, New Brunswick. This meeting was an in-depth meeting to formulate approaches on many of the items to be included in the Regulations. Subsequent conference telephone meetings were held on November 10, 2004, December 9, 2004 and February 16, 2005. In addition, a meeting was held on February 2, 2005 between the Co-chairs and the legislative draft and policy persons to review and further the draft Regulations to that point in time.

[5] At the September 19-20, 2004 in-person meeting, the Committee reviewed communications which had been received from several interested stakeholders, and directed the National Coordinator to reply to such stakeholders on behalf of the Committee. Extensive policy discussions took place at the September meeting with respect to certain items to be contained in the Regulations. The discussions were led by individual members of the Committee to whom responsibility had been delegated for the respective subjects to be considered.

[6] The topic of the nature and quality of financial statements to be included in a disclosure document was discussed at length at the September 19-20, 2004 meeting. The Committee recalled that it had already determined that there should be no exemptions from financial statement disclosure other than for the Crown. The Committee determined, as a first measure, that financial statements to be included in a disclosure document must take the form of either an audited financial statement for the most recent fiscal year, or a review engagement report prepared according to Canadian generally accepted accounting principles. Both of these requirements currently apply in Alberta and Ontario. The Committee also considered whether the Regulations should allow financial statements prepared in a foreign jurisdiction to satisfy the requirements for inclusion of financial statements in a disclosure document. The Committee determined that the use of financial statements prepared in accordance with generally accepted accounting principles of another jurisdiction in which the franchisor is based will be acceptable if the auditing standards or the review and reporting standards of that jurisdiction are at least equivalent to the Canadian standards or, if such standards are not equivalent, the disclosure document contains supplementary information that sets out any changes necessary to make the presentation and content of such financial statements equivalent. In addition, the disclosure document should contain a statement that the financial statements contained in the disclosure document are prepared in accordance with generally accepted accounting principles for the jurisdiction in which the franchisor is based and that the equivalency requirements are satisfied.

[7] The Committee also addressed the issue of the possible use of consolidated statements of a parent company of the franchisor with an appropriate guarantee from the parent company respecting the obligations of the franchisor. Such a procedure is permitted under the FTC Rule in the United States. The Committee concluded that it would be inappropriate for Canadian franchisees

to be deprived of the opportunity to review financial statements of the actual entity with which they are dealing as the franchisor since, in many cases, the parent company would not be located in Canada and the financial statements would most likely not be prepared in accordance with Canadian standards.

[8] The Committee considered the issue of risk warnings or mandatory statements at its September 19-20, 2004 meeting. The Committee felt that any mandatory statements would have to serve a purpose and that, in order to accomplish that objective, they would have to cover matters not otherwise dealt with in a disclosure document. The Committee also agreed that mandatory statements should serve as an early warning system for a prospective franchisee that does not have significant expertise in the area of franchising. In reviewing the current Ontario legislation, the Committee concluded that every disclosure document should include risk warning or mandatory statements with respect to a franchisee seeking information on the franchisor, seeking expert independent legal and financial advice, and contacting current and former franchisees.

[9] The Committee considered the use of wrap-around documents with disclosure documents or offering circulars used by a franchisor in another jurisdiction in compliance with the laws of such other jurisdiction. It was noted that the Alberta legislation currently permits the use of wrap-around statements, whereas the Ontario legislation does not explicitly provide for such right. Following extensive consideration of the subject, the Committee concluded that there was no need to permit the use of wrap-around documents in a Canadian harmonized system, and that the use of such statements would negatively affect the clarity of disclosure documents as a whole.

[10] At its meeting of September 19-20, 2004, the Committee also considered the issue of whether it would be appropriate to mandate specific disclosure certificate forms in the Regulations, one for the disclosure document and one for a statement of material change. The Committee concluded that prescribed forms for both certificates should be included in the Regulations to ensure consistency and certainty with respect to the content and form of such disclosure certificates.

[11] The Committee considered appropriate disclosure with respect to the costs of establishing a franchise at its meeting of September 19-20, 2004. The principles guiding this disclosure item were that categories of start-up fees should be kept distinct, and that the disclosure item should distinguish between initial capital investment and on-going expenses paid to the franchisor. The Committee approved language with respect to this disclosure item in connection with a list of all of the franchisee's costs associated with the establishment of a franchise. It also determined that the disclosure item should include specifically described costs associated with the establishment of the franchise, as well as other recurring or isolated fees or payments made to the franchisor, whether direct or indirect.

[12] At its September 19-20, 2004 meeting, the Committee considered the issue of whether disclosure of annual operating costs was appropriate from a policy perspective, and what would be appropriate mandated disclosure in situations where a franchisor is aware of annual operating costs but does not disclose them. The Committee recommended a disclosure item with respect to any estimates of annual or other periodic operating costs, if such are provided, directly or indirectly, together with a statement specifying the basis for the estimate, the assumptions underlying the estimate and a location where information is available for inspection that substantiates the estimate. Further, if an estimate of annual or other periodic operating costs is not provided, a mandatory statement to that effect should be included in the disclosure item.

[13] At the September 19-20, 2004 meeting the Committee engaged in an extensive discussion with respect to disclosure of earnings projections. It was first noted that current Ontario and Alberta Legislation deal with the subject of earnings claims differently, but neither contains a precise definition of what is meant by the term "earnings claims" or "earnings projection". The Committee reviewed the issue of earnings projections in United States disclosure legislation and noted that such projections are not currently mandatory but, if they are included, they must be extremely detailed. After considerable discussion, the Committee approved draft regulatory language with respect to earnings projections, and also included in the disclosure item an inclusive definition of the term "earnings projection" to mean any information given or to be given by or on behalf of the franchisor or the franchisor's associate, directly or indirectly, from which a specific level or range of actual or potential sales, costs, income, revenue or profits from franchisee business, or franchisor or franchisor affiliate businesses can easily be ascertained.

[14] At the September 19-20, 2004 meeting, the Committee reviewed current disclosure requirements with respect to financing. The Committee concluded that it would be appropriate to extend this disclosure item to include financing arrangements where the franchisor assists third parties to offer goods and services to franchisees.

[15] At the September 19-20, 2004 meeting, the Committee addressed the issue of disclosure of training. The Committee approved draft language with respect to disclosure of training, expanding the current disclosure requirements of the Ontario legislation to deal with payment for training and, if no training or other assistance is provided, a statement to that effect.

[16] At the September 19-20, 2004 meeting, the Committee engaged in extensive discussion with respect to appropriate disclosure concerning advertising. It was determined that the current Ontario disclosure was wholly inadequate, and that use of the terms "national" versus "local" advertising in the Ontario regulations was confusing and, in many cases, inappropriate. The Committee felt that the most important issue concerning advertising disclosure was whether franchisees were required to contribute to an advertising, marketing, promotion

or similar fund and, if so, the disclosure document should describe the fund, including the franchisor's policy and practice in respect of a number of specific items concerning the fund. Further, the disclosure item should contain a statement outlining expenditures from the fund, amounts retained or charged by the franchisor, the amount or percentage of any surplus or deficit of the fund, all for the past two fiscal years, together with another statement describing such items on the basis of projections for the current fiscal year.

[17] At the September 19-20, 2004 meeting, the Committee reviewed disclosure with respect to purchase and sale restrictions. The Committee approved draft regulatory language which would require a description of any restrictions or requirements imposed by the franchise agreement with respect to obligations to purchase or lease from franchisor, and other parties, the goods and services the franchisee may sell, and to whom the franchisee may sell goods or services. Further, there should be a statement as to whether by the terms of the franchise agreement, or otherwise, the franchisor has the right to change a restriction or requirement with respect to purchase and sale of goods or services.

[18] At its September 19-20, 2004 meeting, the Committee engaged in extensive discussions with respect to the area of rebates. From a policy perspective, the Committee was asked to consider how best the regulation might protect franchisees without such extensive disclosure that might prejudice the competitive and business strategies of the franchisor. The Committee initially considered a proposed disclosure item that would contain extensive disclosure with respect to detailed percentages and/or amounts of rebates received by franchisors. However, following further discussion, the Committee approved draft regulatory language which would require a franchisor to describe its policy or practice regarding rebates, commissions, payments or other benefits, whether or not the franchisor or the franchisor's associate may receive or receives any such benefits as a result of the purchase of goods and services by a franchisee and, if so, whether such benefits are or may be shared with franchisees, either directly or indirectly.

[19] The Committee readdressed the issue of disclosure of rebates during the Committee's conference call meeting of November 10, 2004. A minority of the Committee expressed serious reservations with respect to the suggested level of rebate disclosure, noting that rebates paid to or retained by franchisors with respect to required purchases made by franchisees that result in franchisees incurring higher costs than what would otherwise be the case is the source of the majority of franchise disputes. The minority expressed the view that the regulations should expressly require the disclosure of all hidden fees and that the failure to do so would result in inaccurate and often misleading disclosure contrary to the purpose of the legislation. Nevertheless, the majority of the Committee concluded that the suggested draft language, which does not provide for disclosure of the scope of the revenues derived from franchisors from this source, was satisfactory.

[20] At the September 19-20, 2004 meeting, the Committee reviewed appropriate disclosure with respect to intellectual property including, in particular, trade-marks. The Committee approved draft regulatory language in which the franchisor would describe rights to trade-marks, trade names, logos or advertising or other commercial symbols, and other forms of intellectual property associated with the franchise, the status and known impediments to the use of same, and a description of the franchisor's right to modify or discontinue the use of any of the same. This disclosure item is a considerable extension of the current Ontario and Alberta disclosure items on the subject of intellectual property.

[21] At the September 19-20, 2004 meeting, the Committee discussed the issue of disclosure of licences and permits. The Committee felt, as a matter of policy, the franchisor should assume the responsibility for determining required licences and permits, and that the draft regulations should require a description of every licence, registration, authorization or other permission the franchisee is required to obtain in order to operate the franchise.

[22] At the September 19-20, 2004 meeting, the Committee discussed the issue of disclosure of personal participation in the franchise, and approved a draft regulation requiring disclosure as to the extent to which the franchisee is required to participate personally and directly in the operation of the franchise or, if the franchisee is a non-individual entity, to the extent to which the principals would be so required.

[23] At the September 19-20, 2004 meeting, the Committee discussed the issue of disclosure of sales levels as a condition to retaining exclusivity rights. A draft regulatory item was adopted requiring the disclosure of the franchisor's policy or practice, if any, as to whether the continuation of a franchisee's rights to exclusive territory depends upon the franchisee achieving a specific level of sales, market penetration, or other condition, and under what circumstances these rights might be altered if the franchise agreement grants the franchisee rights to exclusive territory.

[24] At the November 10, 2004 meeting, the Committee reviewed the topic of disclosure charts regarding franchisees. It was concluded, consistent with the Committee's objective for full and fair disclosure, that the franchisor's associates and affiliates should be covered. Similarly, express disclosure of corporate or affiliate operated businesses should also be disclosed. Where the franchisor has fewer than twenty (20) franchises in Canada, disclosure by country where the next largest number of such franchisees exist must be made until contact information for twenty or more franchisees has been provided. Finally, the content of disclosure with respect to former franchisees has been substantially expanded both for the purpose of clarity as well as to assist those preparing disclosure documents.

[25] [At the November 10, 2004 meeting, the Committee discussed disclosure with respect to terminations, transfers and reacquired franchises. This discussion was continued at the Committee's conference call meeting of December 9, 2004. The current language contained in the Ontario legislation was considered to be sufficient with some minor clarification changes. The draft regulatory language would require a description of all restrictions on, or conditions to, termination and transfer of a franchise.

[26] At the Committee's meeting of December 9, 2004, the Committee proceeded with a discussion on disclosure with respect to exclusive territory. It was ultimately recommended that the disclosure item should contain a description of the franchisor's policies and practices regarding the granting of specific locations, areas, territories or markets, the approval of same, changes in same, modifications to same, terms and conditions of any options, rights, or similar rights, and the granting of exclusive locations, areas, territories or markets.

[27] At the December 9, 2004 Committee meeting, consistent with the principle of clarity in the disclosure items in the Regulation, the Committee approved a substantially revamped provision dealing with proximity or encroachment. In particular, franchisors should disclose their policies and practices regarding compensating franchisees for encroachment as well in respect of the resolution by the franchisor of conflict between the franchisor and its affiliates and franchisees respecting not only locations but also markets, customers and franchisor support.

[28] At the November 10, 2004 meeting, the Committee reviewed the topic of disclosure charts regarding franchisees. It was concluded, consistent with the Committee's objective for full and fair disclosure, that the franchisor's associates and affiliates should be covered. Similarly, express disclosure of corporate or affiliate operated businesses should also be disclosed. Where the franchisor has fewer than twenty (20) franchises in Canada, disclosure by country where the next largest number of such franchisees exist must be made until contact information for twenty or more franchisees has been provided. Finally, the content of disclosure with respect to former franchisees has been substantially expanded both for the purpose of clarity as well as to assist those preparing disclosure documents.

[29] At the December 9, 2004 Committee meeting, the Committee considered certain additional items not currently contained in the Ontario and Alberta legislation which might be considered for inclusion in the Regulations. These items included a document retention policy, penalties or sanctions, disclosure of requirements for personal guarantees, and disclosure of contents of operating manuals. It was ultimately determined that the subject of personal guarantees and operating manuals should be included in the Regulations.

[30] The Committee has recommended that the Regulations contain a description of the franchisor's policies and practices regarding the requirements for guarantees or security interests from franchisees.

[31] With respect to the subject of operating manuals, the Committee approved a disclosure item in the Regulations requiring that if manuals are provided to the franchisee, there should be disclosure of a summary of the material topics covered in the manuals or a statement specifying where in the particular jurisdiction the manuals are available for inspection. If no manuals are provided to the franchisee, a statement to that effect should be included.

[32] The largest new disclosure item to the Regulations is the inclusion of a mediation process. Committee members were of the view that the availability of mediation was productive in the resolution of franchise disputes. As most provinces do not provide for rules for mediation in their respective Rules of Civil Procedure, the Committee undertook to draft a comprehensive mediation code for use in such jurisdictions.

[33] Following extensive debate over the matter and time for its invocation, the Committee settled on party initiated pre- and post-litigation/arbitration as the most appropriate form of mediation.. For jurisdictions like Ontario and British Columbia that currently have a mediation regime in their Rules of Practice, post litigation mediation is to be governed by the Rules rather than the Regulations. Mediation is to occur within 45 days of the appointment of the mediator and mediation is to be concluded after 10 hours. There is nothing in the Regulations, however, preventing parties from extending mediation beyond the 10 hours. Failure of any of the parties to comply with the requirement to mediate can be subject to an adverse costs award. Unless a court orders otherwise, no more than one mediation may be initiated in respect of the same dispute. A court or an arbitrator may consider an allegation of a default under the mediation provisions by a party in respect of costs in the proceeding or arbitration. A complete set of prescribed forms have been included in the mediation Regulation.

3. Overview of the Draft Act

[34] The Act follows, in its ordering and format, the Ontario Act. It incorporates in certain respects provisions contained in the Alberta Act which are absent in the Ontario Act and which are considered of importance for inclusion in the draft Act. There have been several grammatical and consistency changes incorporated in the Act from the draft Act approved in principle at the 2004 annual meeting of the ULCC. No substantive additions or changes have been made to the Act from the draft Act approved in principle in 2004.

4. Overview of the Regulations

[35] The Regulations follow, in some respects, the ordering and format of the Ontario regulations. However, as noted from the discussion above, many items currently contained in the Alberta or Ontario regulations have been substantially enhanced with additional disclosure requirements, definitions and more clarity in wording. In addition, new disclosure items have been included in the Regulations where it was considered appropriate, reasonable and necessary. In particular, the mediation Regulation is considered by the Committee to represent a significant and positive development in connection with the resolution of franchise disputes, in the interests in all stakeholders.

Recommendation

[36] It is recommended that the ULCC approve and adopt the model Act and the model Regulations attached to this report.