Franchising in Canada: Considerations for U.S. franchisors

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Canada is an attractive market for U.S. franchisors who are looking to expand their business internationally. Canada is generally quite open to foreign investment (particularly from the U.S.), and there are many similarities between Canadian consumers, business practices and legislative frameworks, and those in the U.S. From this perspective, expanding into Canada can be an easier undertaking for many U.S. franchisors than expanding into other countries. However, there are a number of important differences between Canadian and U.S. franchise laws, and U.S. franchisors should ensure that they know and understand how Canadian franchise laws differ and how they will affect their business before taking any steps to enter the Canadian marketplace.

Regulation of franchising in Canada

Unlike the U.S., Canada has no federal legislation that governs franchising throughout the country. In Canada, franchising falls within provincial jurisdiction over “property and civil rights”, which includes contract law. The provinces of British Columbia, Alberta, Manitoba, Ontario, New Brunswick and Prince Edward Island have each enacted franchise legislation, which governs the offering and sale of franchises in those jurisdictions. There is no specific franchise legislation in place in any of the other provinces or territories, which means that franchising in most of those jurisdictions is largely dealt with as a matter of contract law.

Unlike the rest of the provinces and territories in Canada, whose legal systems are based on the common law, Québec maintains a civil law system under the *Civil Code of Québec*. Under the *Civil Code*, most franchise agreements will be considered “contracts of adhesion” since they are drafted by or on behalf of one party (the franchisor) and their terms are not negotiable by the other party (the franchisee). The *Civil Code* sets out specific requirements for contracts of adhesion, which are discussed in further detail below.

In Canada, there is no regulator or governmental agency with specific responsibility for franchising. Franchisors are not required to register with a specific franchise regulator, and there is no requirement for a franchisor to file its form of franchise disclosure document with any governmental agency. Instead, franchisors and franchisees are

largely left to manage their own affairs under the terms of their franchise agreements and applicable franchise legislation in the provinces that have enacted it.

Franchise legislation in Canada

Franchisors intending to offer franchises in the provinces of British Columbia, Alberta, Manitoba, Ontario, New Brunswick and Prince Edward Island must comply with the specific franchise legislation enacted in those jurisdictions. There are many similarities among the franchise statutes in these provinces. Most significantly, each of them require franchisors who wish to offer franchises in their respective jurisdictions to provide prospective franchisees with a disclosure document prior to the signing of a franchise agreement or the payment by the prospective franchisee of any consideration relating to the franchise.

Each of the franchise statutes requires that a disclosure document that is provided to a prospective franchisee contain all “material facts” relating to the franchise being offered. This is defined as any information about the business, operations, capital or control of the franchisor, or about the franchise system, that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise. This is different from the disclosure experience in the U.S., where the information franchisors are required to disclose to prospective franchisees is generally limited to a finite list. In Canada, a franchisor must consider in each case what information might constitute a material fact from the perspective of a prospective franchisee and ensure that all such information is included in the franchise disclosure document that is provided to the prospective franchisee.

In addition to the general requirement to disclose all material facts, the regulations that have been enacted under each of the various franchise statutes specify certain required information, which must be included in a disclosure document. This information differs slightly from one province to the next, but generally includes the following:

- background information regarding the franchisor and its directors, general partners and officers;
- any civil action to which the franchisor or any of its directors, general partners or officers is a party involving claims or findings of misrepresentation, unfair or deceptive business practices or a violation of any law regulating franchises or businesses;
- any bankruptcy or insolvency proceedings, voluntary or otherwise, involving the franchisor or any of its directors, officers or general partners as debtor;
- the initial franchise fee and any ongoing fees that the franchisee must pay to the franchisor;
- the initial investment required by the franchisee to establish and begin operating the franchise;
- the terms and conditions of any financing offered by the franchisor to the prospective franchisee;
- any restrictions on the products or services the franchisee may sell, who they can purchase products or services from for use in connection with their business, or who they may offer products or services to;
- whether the franchisor receives any volume discounts, rebates or other benefits as a result of purchases of products or services by franchisees;

- whether the franchisee or its principals are required to participate directly in the day-to-day operation of the franchised business;
- a listing of existing franchise outlets and any outlets the franchisor operates;
- details regarding the closure of any franchisee outlets during the last three fiscal years of the franchisor;
- any exclusive territory granted to the franchisee and the franchisor's policy regarding the proximity between an existing franchise outlet and another franchise, outlet or other method of distribution established or used by the franchisor;
- any provisions of the franchise agreement relating to the termination or renewal of the franchise agreement or the transfer of the franchise; and
- financial statements of the franchisor for its most recently completed fiscal year.

Franchisors must provide a disclosure document to a prospective franchisee at least 14 days before the franchisee signs a franchise agreement or any other agreement relating to the franchise being offered, or pays any consideration to the franchisor in relation to the franchise.

If a franchisor becomes aware of a "material change" after providing a disclosure document to a prospective franchisee, the franchisor must provide the prospective franchisee with a written statement of material change before the franchisee signs the franchise agreement or any other agreement relating to the franchise. A "material change" is similar to a "material fact", except that a "material change" is limited to facts that would reasonably be expected to have a "significant adverse effect" on the value or price of the franchise to be granted or on the prospective franchisee's decision to acquire the franchise. The franchisor must provide the statement of material change to the prospective franchisee as soon as practicable after the change occurs.

Each of the Canadian franchise statutes provide franchisees with statutory rescission rights in circumstances where a franchisor has failed to comply with its disclosure obligations. If a franchisor fails to provide a disclosure document in accordance with the 14-day timeframe or the contents of the disclosure document do not meet the requirements of the legislation, the franchisee will have the right to rescind the franchise agreement within 60 days after receiving the disclosure document. If a franchisor fails to provide a disclosure document altogether, the franchisee will have the right to rescind the franchise agreement within two years after signing the franchise agreement. If a franchisee exercises one of its rescission rights, the franchisor must, within 60 days:

1. refund to the franchisee any money received from the franchisee in relation to the franchise, other than money for inventory, supplies or equipment;
2. purchase from the franchisee any remaining inventory that the franchisee purchased pursuant to the franchise agreement, at a price equal to the purchase price paid by the franchisee;
3. purchase from the franchisee any supplies or equipment that the franchisee purchased pursuant to the franchise agreement, at a price equal to the purchase price paid by the franchisee; and
4. compensate the franchisee for any losses the franchisee incurred in acquiring, setting up and operating the franchise, less the amounts previously described.

As the list above makes clear, the amounts that a franchisor can be liable for in connection with a rescission claim can be significant, as all losses incurred by the

rescinding franchisee in connection with the purchase of the franchise must be compensated. Accordingly, the rescission rights granted by Canadian franchise legislation provide powerful remedies to franchisees and strong incentives for franchisors to comply with their disclosure obligations.

Canadian franchise legislation also provides remedies for franchisees that have suffered losses due to a misrepresentation contained in a disclosure document or as a result of a franchisor's failure to comply with its disclosure obligations. Under each of the various franchise statutes, a franchisee has a right of action for damages against a franchisor, the franchisor's broker, the franchisor's associate, and every person who signed the disclosure document, in relation to any such loss incurred by the franchisee.

Unlike franchise legislation in certain jurisdictions in the U.S., Canadian franchise statutes do not purport to regulate the relationship between franchisors and franchisees, other than by imposing a duty of fair dealing on each of the parties to a franchise agreement. Canadian franchise statutes do not place any requirements or restrictions on the termination, non-renewal or transfer of the franchise agreement, territory protection or supply issues, in the same way that some U.S. statutes do.

In Canada, the duty of fair dealing applies to the performance and enforcement of the franchise agreement and the exercise of a right under the franchise agreement. The duty of fair dealing includes the obligation to act in good faith and in accordance with reasonable commercial standards. If a party to a franchise agreement breaches the duty of fair dealing, the other party will have a right of action for damages against that party in relation to the breach.

Each of the various franchise statutes provide that any provision in a franchise agreement attempting to restrict the application of the law of that province, or to restrict jurisdiction or venue to a forum outside that province, is void with respect to a claim that is otherwise enforceable under the legislation in that province. Each of the franchise statutes also provide that any purported waiver or release by a franchisee of a right under the legislation or of any obligation or requirement imposed on a franchisor by or under the legislation is void. Accordingly, the parties to a franchise agreement that is subject to one of the franchise statutes cannot contract out of its application.

Franchising in Québec

As noted above, in Québec, franchise agreements are generally considered "contracts of adhesion" which are subject to specific requirements under the *Civil Code*. Among other things, a contract of adhesion must be drafted in clear and understandable language and may not refer to provisions in other contracts unless those provisions are expressly brought to the non-drafting party's attention and incorporated by reference into the contract. Any abusive or overly onerous provisions may be found null and void, or may be reduced in their effect, and the contract as a whole will be interpreted in favour of the non-drafting party. Given the specific requirements applicable to contracts of adhesion under the *Civil Code*, U.S. franchisors who are considering expanding into Québec should seek advice from local counsel who have experience in franchising, and have their form of franchise agreement reviewed to ensure that it complies with the requirements of the *Civil Code*.

Key takeaways for U.S. franchisors

Franchising in Canada will likely look familiar to U.S. franchisors, which makes it an attractive and relative easy jurisdiction to expand their business. However, U.S. franchisors must keep in mind that Canada is its own country with its own distinct laws and compliance with those laws is essential in order to avoid the significant consequences of non-compliance. U.S. franchisors who are considering expanding into Canada should consult with experienced Canadian franchise counsel who can assist them in ensuring that their expansion approach, business practices and franchise documents, comply with (and are optimized) for Canadian franchise laws. BLG's Franchise, Licensing and Distribution Group has significant experience working with U.S. franchisors of all sizes and across all industries, and can help U.S. franchisors to ensure that their expansion into Canada starts off on the best possible footing.

By

Blair Rebane, Eric C. Little

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BLG Offices

Calgary
Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3
T 403.232.9500
F 403.266.1395

Ottawa
World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9
T 613.237.5160
F 613.230.8842

Vancouver
1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2
T 604.687.5744
F 604.687.1415

Montréal
1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4
T 514.954.2555
F 514.879.9015

Toronto
Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3
T 416.367.6000
F 416.367.6749

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