

Franchising in Canada: Best practices for global brands

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This article is part of a practical series written for international companies looking to establish, launch, operate or invest in a business Canada. Each article covers a major area of law in Canada – everything from employment laws to taxes. Access all the articles on the [“Doing business in Canada: A practical guide from ‘Eh’ to ‘Zed’”](#) page.

Franchising is a method of doing business and facilitating business expansion. It normally involves the grant of a licence to the franchisee permitting the franchisee to use the franchisor’s intellectual property and system of carrying on business in exchange for a fee.

The extent of a franchisor’s involvement in the ongoing operation of the franchise will vary considerably depending on the nature of the franchise agreement. In a “turnkey” franchise, the franchisor is entirely responsible for construction and set-up of the franchise premises, and exercises continuing supervision over its operation. At the other extreme, is a “distributorship” relationship, which limits the franchisor’s role to supplying the franchisee with products for resale in exchange for royalties.

Franchise agreements must be distinguished from agency and distribution contracts. In an agency relationship, the agent simply effects the sale of a product on behalf of the principal in return for a commission. The agent does not actually buy the product. Distributorships are businesses that purchase inventory for resale to other businesses.

The line between franchise and distributorship is not always clear and will usually depend on the degree of control exercised over the distributor or franchisee. The distinction between the two becomes especially important in determining whether a particular relationship falls within the scope of franchise legislation in effect in most provinces.

Franchise structure

A franchise system may be structured as a unit franchise, an area development franchise or a master franchise. A unit franchise involves the granting of individual franchise rights directly to a franchisee. Alternatively, it is possible to delegate to an area developer responsibility for marketing the franchise system and identifying potential

franchise locations within a specified territory. In a master franchise system, the master franchisee sublicenses franchise rights to unit franchisees. The master franchise agreement will normally preserve a measure of control for the franchisor over the expansion and set an appropriate apportionment of fees between the master franchisee and the franchisor.

Foreign franchisors

There are several business structures available to a foreign-based franchisor wishing to expand into the Canadian market using the franchise method. The first is to operate the franchise directly from the franchisor's existing foreign-based corporate structure. While such direct franchising has the advantage of minimal start-up costs, it exposes the franchisor to liabilities incurred by Canadian operations, and the lack of a local presence may detract from the effectiveness of the franchisor's marketing in Canada.

Alternatively, a foreign-based entity seeking to expand into the Canadian market can establish a branch office to administer the granting of franchise rights in Canada.

However, this approach may attract Canadian income tax liability and does nothing to insulate the franchisor from the operating losses and liabilities of its Canadian branch.

Third, a foreign-based franchisor may opt to incorporate a Canadian subsidiary.

Although incorporation will serve to immunize the foreign franchisor from Canadian liabilities and operating losses, the other implications of such a structure, such as tax consequences, should be carefully considered.

Compliance with federal and provincial legislation

Although Canada has no comprehensive federal franchise legislation equivalent to the United States' Federal Trade Commission Franchise Rule, there are several federal statutes of general application that can affect franchise relationships. Of particular significance are the *Competition Act*, the *Trade-marks Act*, the *Investment Canada Act*, and the *Income Tax Act*, which govern, respectively, competition and trade practice matters, the registration and protection of trademarks, and investment and taxation rules to which foreign-based franchisors are subject.

Certain types of provincial legislation of general application, such as liquor licensing, employment standards, commercial tenancy and personal property security acts, may also be applicable.

In addition to these generally applicable laws, the provinces of Alberta, Ontario, Prince Edward Island, New Brunswick, Manitoba and British Columbia have enacted specific legislation that regulates franchise relationships, as discussed below. The Civil Code of Québec and Charter of the French Language also merit the attention of any franchisor considering expansion into the Province of Québec.

Alberta

Alberta was the first province in Canada to enact franchise-specific legislation. The stated purpose of Alberta's Franchises Act is to assist prospective franchisees in making informed investment decisions, to promote fair dealing in franchise relationships, and to provide civil remedies for breaches of the legislation. Important features of this statute include:

- the requirement that franchisors give prospective franchisees a disclosure document at least 14 days before any payment is made or any agreement is signed relating to the franchise;
- the imposition of a duty of fair dealing on each party to a franchise agreement;
- a right of action in the franchisee for any losses arising from misrepresentations contained in the disclosure document; and
- the right of a franchisee to rescind the franchise agreement if the franchisor fails to provide the requisite disclosure document.

The term “franchise” is broadly defined in the Alberta *Franchises Act*. Payment of a franchise fee is not an essential component of the definition, provided the franchisee has a continuing financial obligation to the franchisor and the franchisor maintains significant continuing control over the operation of the franchised business. As a result, distribution-type relationships must be carefully examined to determine whether they fall within the scope of the Alberta *Franchises Act*.

It is also noteworthy that the Alberta *Franchises Act* applies to the sale of a franchise only if the franchisee is an Alberta resident or has a permanent establishment in Alberta for the purposes of the Alberta *Corporate Tax Act*. The Alberta *Franchises Act* also mandates Alberta law as the governing law of any franchise agreement.

Ontario

Ontario became the second province to enact franchise legislation in Canada when the *Arthur Wishart Act (Franchise Disclosure)*, 2000 came into force in 2000. Ontario’s franchise act is similar to its Alberta counterpart, but differs in several important respects. First, its application is not limited to prospective franchisees that reside in or have a permanent establishment in Ontario, but rather extends to any franchise to be operated partly or wholly in Ontario. Second, Ontario requires more detail in its mandatory disclosure document. That document must include: warnings that prospective franchisees should obtain independent advice and contact current or previous franchisees before entering into the agreement; extensive information on the directors, general partners and officers of the franchisor corporation; and a description of every licence, registration, authorization or other permission that the franchisee will be required to obtain in order to operate the franchise.

Prince Edward Island, New Brunswick, Manitoba and British Columbia

Prince Edward Island’s *Franchises Act* came into force on January 1, 2007, New Brunswick’s *Franchises Act* came into force on February 1, 2011, Manitoba’s the *Franchises Act* came into force on October 1, 2012, and British Columbia’s *Franchises Act* came into force on February 1, 2017. In most respects, the franchise legislation of Prince Edward Island, New Brunswick, Manitoba and British Columbia is similar to Ontario’s *Arthur Wishart Act (Franchise Disclosure)*, 2000, in that those four statutes impose requirements on a franchisor to provide a disclosure document to a prospective franchisee, provide a right of rescission if a disclosure document is not provided, require good faith and fair dealing between a franchisor and a franchisee, and protect franchisees’ rights to associate. The information that a franchisor must include in a disclosure document with respect to a franchise in Prince Edward Island, New Brunswick, Manitoba or British Columbia is detailed in the regulations to each province’s

Franchises Act and is very similar, but not identical, to that which must be included in a disclosure document in Ontario.

Québec

Most franchise agreements will qualify as “contracts of adhesion” under the Civil Code of Québec, as they are drawn up by or on behalf of one party (the franchisor) and their terms are not negotiable by the other party (the franchisee). Under the Civil Code of Québec, a contract of adhesion must be couched in clear and understandable language. It may not refer to provisions in other contracts unless those provisions are expressly brought to the franchisee’s attention. Any abusive or excessively onerous provisions may be found null and void or may otherwise be reduced in their effect. The contract as a whole will be interpreted in favour of the franchisee.

The Charter of the French Language also applies to franchising, as it mandates French as the language of commerce and business in the Province of Québec. The Charter of the French Language is discussed further in [Canadian language laws](#).

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