

IBA/IFA 27th ANNUAL JOINT CONFERENCE

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NEW APPROACHES AND CHALLENGES IN INTERNATIONAL FRANCHISING

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NEWS FROM AROUND THE WORLD: CANADA

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**Peter Snell
Gowling Lafleur Henderson LLP
Vancouver, British Columbia, Canada**

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1. Introduction

Oh Canada! During the past year there have been a lot of interesting developments in Canada in legislation and case law affecting franchising.*

As franchise disclosure laws are under the jurisdiction of the provinces in Canada, and not the federal government, what has developed is a patchwork of franchise legislation across the country. As Canada does not have franchise registration requirements or governmental review of disclosure documents, it has been left up to the courts to interpret the provincial legislation and its application to disclosure documents and franchise agreements. The results at times have been inconsistent and often controversial. The net result is that franchise practitioners in Canada have to be extremely careful in crafting disclosure documents and franchise agreements to comply with the provincial legislation, and the interpretations of the provincial laws as dictated by the courts.

While not every case or legislative development can be covered here in this article, the highlights will be discussed.

2. Manitoba Franchise Legislation

On June 17, 2010 the Manitoba *Franchises Act* (C.C.S.M. c. F156 (Man.)) received Royal Assent making Manitoba the fifth province in Canada to have franchise legislation. It was thought that the draft disclosure regulations would be released in early 2011, but as of writing May 1, 2011, they have yet to be released. It is anticipated that the draft regulations will be released soon and would likely come into force in 2012.

Manitoba has followed a similar path to P.E.I. and New Brunswick in largely adopting franchise legislation that is modeled on the Ontario Act, but has unique differences. Some of these may be addressed in the disclosure regulations, but that has yet to be seen. In particular, of note are the following provisions in the Manitoba Franchises Act:

- Disclosure documents must be “substantially complete” to satisfy the delivery requirement. This allows for technical irregularity or mistake not affecting the substance of the document. This provision will give franchisors some comfort as the tide of franchise case law has been to find more of a strict compliance approach.
- There is no “one document at one time” requirement (as found in the Ontario Act). The implication is that the 14 day disclosure waiting period starts after the prospective franchisee receives the last part of the disclosure document. The challenge of this provision will be trying to determine when the disclosure obligation ends.
- The PEI Act provides that its legislation does not apply to any arrangement arising out of an agreement for the purchase of a reasonable amount of goods or services at reasonable wholesale prices. Manitoba’s Act also incorporates this into its provisions.
- Unlike the Ontario Act, the sophisticated franchisee (a franchisee who will invest in the franchise more than 5 million dollars in a year) exemption is not included.

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- Deposit agreements, site selection and confidentiality agreements (in limited circumstances) will be permitted within the 14 day disclosure period.

3. New Brunswick Franchise Legislation

The grant of franchises in the Province of New Brunswick is now subject to regulation as of February 1, 2011, joining the Provinces of Ontario, Alberta and Prince Edward Island with pre-sale disclosure legislation in Canada.

Like the Alberta and Prince Edward Island franchise laws, the New Brunswick Act allows for the use of a disclosure document prepared for use in another jurisdiction provided that additional information is included, through what is generally called a wrap-around document, in order to comply with the requirements of the New Brunswick Act.

Two separate regulations were approved: the Disclosure Document Regulation and the Mediation Regulation. The latter prescribes the method of delivery of a notice of dispute and a notice to mediate which, under the New Brunswick Act either party to a franchise agreement is entitled to initiate. The Mediation Regulation also prescribes the method for appointing a mediator, the timing and conduct of mediation and forms to be used for notices, statements of facts and issues and the certificate of completed mediation. The Disclosure Document Regulation prescribes the items of information required to be disclosed by a franchisor in its disclosure document.

While the disclosure Regulations under New Brunswick's Franchises Act mirror, in many respects, the regulations to the franchise legislation in Ontario, Alberta and Prince Edward Island, there are some note-worthy differences that will require changes to a "Canada-wide" disclosure document. This article will address those provisions of the Disclosure Regulation which are unique or which differ significantly from the regulations under Ontario's Arthur Wishart Act (Franchise Disclosure), 2000 (the "Ontario Regulations") which do not expressly allow for the use of a wrap-around document.

- In addition to specific information required to be disclosed pursuant to the *Disclosure Document Regulation*, it also requires in a number of instances for a form of "negative disclosure". For example, if the franchisor does not provide earnings projections, the disclosure document must provide a statement to that effect. Similarly, if training or other assistance is not offered to the franchisee, a statement to this effect must be included in the disclosure document. The Certificate of Franchisor, which must be in the form of Form 1 of the *Disclosure Document Regulation* must also include a prescribed statement if the franchisor is relying upon an exemption under the *Disclosure Document Regulation* from providing financial statements.
- Disclosure of information relating to criminal convictions, administrative orders and proceedings, civil proceedings and bankruptcy are limited to the 5 year period prior to the date of the disclosure document while under the Ontario Regulations, such disclosure must be provided for 10 years in the case of criminal convictions, 6 years for bankruptcy and with no period limitation for civil actions and administrative proceedings.
- Disclosure of background information of the franchisor must include a description of and the number of franchises granted by the franchisor of a different type of franchise system during the 5-year period prior to the date of the disclosure document and how long they have been offering such franchises (like the disclosure required under the *Franchises Act* (PEI)).

- As part of the disclosure pertaining to the franchise, the franchisor is required to disclose its policies and practices regarding guarantees and security interests required of franchisees (similar to the requirement under PEI's disclosure requirements). Although it has become common practice to disclose such information in Ontario under the catch-all disclosure requirement of "all material facts", there is no express provision requiring such disclosure in the Ontario Regulations.
- The *Disclosure Document Regulation* provides a definition of "earnings projection" which is the same as the definition provided in the Regulations to the *Franchises Act* (Prince Edward Island). It is defined as follows:

"earnings projection" includes any information given by or on behalf of the franchisor or franchisor's associate, directly or indirectly, from which a specific level or range of actual or potential sales, costs, income, revenue or profits from franchises or businesses of the franchisor, franchisor's associates or affiliates of the franchisor of the same type as the franchise being offered can easily be ascertained.

As with the Regulations to the *Franchises Act* (PEI), the *Disclosure Document Regulation* refers to the provision by the franchisor of an earnings projection, "directly or indirectly".

- If the franchisee is required to operate in accordance with the franchisor's manuals, either the table of contents of the manuals must be included in the disclosure document or a statement specifying *where in New Brunswick the manuals are available for inspection*. It is not yet clear whether this will be interpreted as giving the prospective franchisee the right to inspect the manuals or just their table of contents.
- As part of the franchisor's disclosure regarding exclusive territory and proximity of units, the franchisor must disclose its policies and practices relating to internet sales or other "distance sales" (which term is not defined in the Act or the Disclosure Document Regulation).
- The requirement to disclose permits, licences and other authorizations required by a franchisee to operate its business is restricted under the Disclosure Document Regulation to those under federal or provincial law and does not extend to municipal laws as does the equivalent requirement under the Ontario Regulations. However, the Disclosure Document Regulation also requires a statement in the disclosure document that the franchisee should make inquiries to determine whether any other federal, provincial or municipal laws or by-laws require permits, licences or other authorizations in order to operate the franchise.
- If the franchisor has the right to unilaterally amend any terms or conditions of the franchise agreement, this must be stated while it is only optional to provide the specific terms that may be unilaterally amended.
- If the number of franchisees in New Brunswick is less than 20, the list must include information on franchisees that operate franchises of the same type in Ontario, Quebec, Prince Edward Island, Nova Scotia or the State of Maine. If there are still less than 20 franchisees listed, then the list must include information on franchisees operating franchises elsewhere in Canada.

- The list of former franchisees must be gathered from both the Province of New Brunswick and from those jurisdictions from which the list of current franchisees have been drawn.
- In addition to information on current franchisees, the franchisor is also required to provide information on other businesses operated in New Brunswick by the franchisor, franchisor's associates or affiliates that are of the same type as the franchise being offered. A franchise is deemed to be the same type as another business if it is operated under the same trademark, trade name, logo or advertising or other commercial symbol.
- Delivery of a disclosure document by courier or by electronic means is expressly permitted under the Disclosure Document Regulation
- A Statement of Material Change must be in prescribed form and must be signed and dated in the same manner as the signing of the Certificate of Franchisor.

Although substantially similar to the disclosure regulations of the other provinces in Canada with franchise legislation, there are enough differences prescribed under the *Disclosure Document Regulation* that franchisors must take care to ensure that their current disclosure documents are modified as necessary if they plan to franchise in the Province of New Brunswick.

4. Proposed Ontario Legislative Reform

Arthur Wishart Act (franchise Disclosure), 2000

Radical changes have been proposed to Ontario's franchise disclosure law, the Arthur Wishart Act (Franchise Disclosure), 2000 (the "Ontario Act"). Since then, Bill 102 passed Second Reading and has now been referred to the Standing Committee on Finance and Economic Affairs. At the moment, the Standing Committee on Finance and Economic Affairs has not put Bill 102 on the agenda and it is possible that the Bill will not proceed any further. If it does, it is expected that the Standing Committee will hold public consultations, during which the franchise community in Ontario will have an opportunity to voice concerns about the Bill.

At the heart of Bill 102 is the requirement that a franchisor provide a prospective franchisee with an "educational document" setting out extensive criteria to be considered in respect of a prospective franchisee's decision to enter into a franchise agreement and to obtain from the prospective franchisee, prior to entering into the franchise agreement, a signed, written acknowledgement that the franchisee has reviewed the educational document. Some of the criteria to be provided in this educational document include the following:

- Self-evaluation criteria to consider including:
 - whether the prospective franchisee has the capital required for the investment;
 - whether the prospect has the necessary management skills, education and work experience;
 - whether the prospect is fully aware of the work involved in operating the franchised business;

- what would be the best franchise for the prospect considering lines of business that are successful and that expected to continue to be successful and lines of business which the prospect is interested in; and
- whether entering into the franchise agreement is the only means by which the prospective franchisee may succeed in the line of business which he is interested in.
- Issues for the prospective franchisee to consider relating to the franchisor and the franchised business, including:
 - the financial stability of businesses associated with the franchise;
 - the extent to which the franchisor is selective when choosing prospective franchisees; and
 - whether the franchisor has introduced any new innovations.
- Issues for the prospective franchisee to consider with respect to the goods and services to be sold or offered from the franchised business, including:
 - what makes the goods or services unique; and
 - whether there is reasonable demand for the goods and services
- Issues with respect to location and sales territory, including:
 - whether the territory is clearly defined and exclusive and what guarantees are provided (*emphasis added*); and
 - the sales potential for the territory.
- Issues that the prospective franchisee may wish to raise with other franchisees, including:
 - any hidden or unexpected costs;
 - the frequency and reliability of deliveries from the franchisor; and
 - any serious disagreement with the franchisor, the nature of the disagreement and the resolution.
- Issues with respect to the franchise agreement, including:
 - whether the agreement protects both franchisor and franchisee
 - whether royalty payments may be deferred to a later, more profitable month; and
 - whether the prospective franchisee is required to follow franchisor controls and policies exactly or whether some creativity may be exercised.

The above is only a fraction of the criteria and matters proposed by Bill 102 to be included in the educational document. What is unclear is whether the prescribed information to be provided in the educational document is in addition to that which is already required to be disclosed under the Ontario Act.

While there are doubts among those in the franchise bar that Bill 102 will pass into law, the private members Bill was tabled as a joint effort by members of Ontario's 3 main political parties and passed Second Reading notwithstanding the well-founded concerns put forward by the Canadian Franchise Association to the members of the Ontario legislature.

The amendments proposed by Bill 102 would add to the already significant disclosure obligations imposed upon franchisors in Ontario and would also require that the franchisor now serve as educator to prospective franchisees in this province.

New Workplace Violence Prevention Law Now in Effect

Employers in Ontario now must comply with the new Workplace Violence Prevention law. The Occupational Health and Safety Act (the "OHS Act") has been amended to prevent and manage workplace violence and harassment. These changes to the Act came into effect and are enforceable as of June 15, 2010. The amendments explicitly set out a duty for every Ontario employer to take specific steps to proactively prevent and manage workplace violence. Legal compliance starts with a risk assessment.

The OHS Act contains definitions for workplace violence and workplace harassment. Workplace violence means the exercise of physical force by a person against a worker, in a workplace, that causes or could cause physical injury to the worker. It also includes an attempt to exercise physical force or a statement or behaviour that a worker could reasonably interpret as a threat to exercise physical force against the worker in a workplace. Workplace harassment means engaging in a course of vexatious comment or conduct against a worker in a workplace that is known or ought reasonably to be known to be unwelcome.

Risk Assessment

Employers must conduct a risk assessment of workplace violence that may arise from the nature of the workplace, type of work or conditions of work. For example, the activities workers perform, whether workers are required to travel, work alone or work late at night as well as access control and security and surveillance systems. The risk assessment must also consider circumstances common to similar workplaces – the activities or work conditions that certain sectors have in common and circumstances specific to the workplace such as layout and design and geographic location. If an employer has multiple work locations, each location should be assessed for its own unique risks of workplace violence in addition to the common risks.

Employers must prepare and review at least annually, a policy with respect to workplace violence and harassment. The policy is required regardless of the size of the workplace or the number of workers. If more than five workers are regularly employed at a workplace, the policy must be in writing and posted in the workplace. Employers may prepare separate policies on workplace violence and workplace harassment or they may combine their workplace violence policy with an existing workplace harassment policy.

The employer must also develop a program to implement the workplace violence and workplace harassment policy. The program must include measures and procedures to control the risks identified in the workplace violence risk assessment as well as measures and procedures for workers to report

incidents of workplace violence and harassment to the employer, for summoning immediate assistance when workplace violence or harassment occurs or is likely to occur and how the employer will investigate and deal with incidents or complaints of workplace violence and harassment. The OHS Act also places a duty on an employer to take every reasonable precaution for the protection of a worker, if the employer knows or ought to reasonably know that domestic violence may occur in the workplace and likely expose a worker to physical injury.

The employer must also provide information and instruction to its workers on its workplace violence and harassment policy and program. In particular, the employer will be required to disclose to its workers the risk of violence from a person with a history of violent behaviour who they may encounter in the course of work and if the risk of workplace violence is likely to expose the worker to physical injury. The Ontario Ministry of Labour recently released a guidance document titled 'Workplace Violence and Harassment: Understanding the Law'.

Enforcement

The Ontario Ministry of Labour has stated that it is committed to enforcing the new amendments to the OHS Act. Employers who did not complete their Risk Assessment, policy, program and training by June 15, 2010 are at risk of enforcement actions including Orders and Prosecutions. Directors and Officers must ensure their organizations are in full compliance or risk personal liability. Corporations may be fined up to \$500,000.00 and individuals may be fined up to \$25,000.00 or jailed for 12 months or both. Compliance with the new amendments to the OHS Act is not only the law, it is also the right thing to prevent workplace violence.

5. Other Legislation Affecting Franchising in Canada

Price Maintenance Provisions of Competition Act Decriminalized

Amendments in 2010 to Canada's Competition Act have decriminalized the price maintenance provisions. As a result, franchisors may have more flexibility to influence franchisee pricing. In particular, except where doing so could have an "adverse effect on competition", franchisors will be better able to influence the price at which their franchisees sell, offer to sell or advertise products.

Prior to the amendments, it was per se illegal (meaning that the effect of the conduct on competition was irrelevant) to:

- by agreement, threat, promise or any like means, attempt to:
 - influence upward, or discourage the reduction of, the price at which a person supplied, offered to supply or advertised a product within Canada; or
 - induce a supplier as a condition of doing business, to refuse to supply a product to a particular person or class of person, because of their low pricing policy; or
- refuse to supply a product to, or otherwise discriminate against, a person because of their low pricing policy.

Price maintenance is now a civil reviewable practice, rather than a criminal offense, meaning that it is presumptively lawful unless and until it is proven to have an adverse effect on competition.

The Competition Bureau or an affected person may attempt to prove to the Competition Tribunal that the relevant price maintenance conduct has had, is having, or is likely to have an adverse effect on competition. If the Competition Tribunal agrees, its remedy powers are limited to granting an order to cease and desist the price maintenance conduct and/or to cause the supplier to supply the product within a specified time to those persons to whom it had previously refused to supply. There will be no fine, jail sentence, administrative monetary penalty or damages award.

This is not to say that franchisors have nothing to lose by engaging in price maintenance, as defending a challenge may entail considerable expense and adverse publicity, even if the franchisor is ultimately successful in the proceedings. However, franchisors who are prepared to accept these risks now have more flexibility to influence franchisee pricing than they did prior to the amendments.

As of May 1, 2011, there is no case law or Competition Bureau guidelines to assist in determining how the amended provisions will be administered and enforced. However, if the Competition Tribunal considers the same factors that U.S. courts have considered in deciding recent price maintenance cases under U.S. law (and we believe that it likely will, at least to some degree), then it will take into consideration the following:

- Whether the manufacturer/supplier/franchisor or a dealer/retailer/franchisee have market power (over 35% market share). If a manufacturer/supplier/franchisor lacks market power, then it is less likely that a price maintenance policy implemented by that manufacturer/supplier/franchisor will have an adverse effect on competition;
- Whether price maintenance policies are commonly used in the industry. Price maintenance policies will generally be more carefully scrutinized if many competing manufacturers/suppliers/franchisors engage in price maintenance; and
- Whether the price maintenance policy originates with the manufacturer/supplier/franchisor or with the dealer/retailer/franchisee. An adverse effect on competition is more likely to be found in situations where a price maintenance policy results from pressure applied by dealers/retailers/franchisees.

Franchisors are strongly encouraged to consult legal counsel before implementing a price maintenance policy. Among other things, caution needs to be taken to ensure that a price maintenance policy does not contravene the criminal provisions of the Competition Act relating to horizontal agreements between competitors, amendments to which came into force on March 12, 2010.

Canada Consumer Product Safety Act

New consumer products legislation in Canada will have an impact on many franchise systems doing business in Canada. The Canada Consumer Product Safety Act (“CCPSA”) was passed on December 13, 2010, and received Royal Assent on December 15, 2010. Health Canada, the government agency responsible for oversight and implementation of the CCPSA, expects it will come into force in “a few months”.

The CCPSA will totally revamp the regulation of consumer products in Canada and franchisors need to consider what steps they need to take to ensure compliance.

The new CCPSA regulatory regime prohibits the manufacture, importation, advertising or sale of any consumer products that pose – or could be expected to pose – a danger to human health or safety. A

danger to human health or safety means an unreasonable danger arising out of the normal and foreseeable use of the product.

Health Canada must be informed of an adverse event anywhere in the world regarding a consumer product that has resulted, or could have resulted, in death or serious adverse health effects, and/or of a recall or other measure initiated by a foreign government for human health or safety reasons. An initial report must be provided within 2 days of becoming aware of the event, with a follow-up report including proposed remedial measure within 10 days.

Inspectors under the CCPSA may enter any location, other than a private dwelling house, if they believe that a consumer product is manufactured, imported, packaged, stored, advertised, sold, labeled, tested, or transported on the premises, or if they believe the premises may contain documents relating to those activities. The Inspectors have broad powers of search and seizure under the legislation.

The Minister of Health is given broad powers to order a product recall, or any other measures that he or she believes are necessary to address or prevent a danger to human health or safety. If the event of non-compliance with the Ministerial Order, Health Canada may undertake enforcement measures at the expense of the non-compliant person.

Documents relating to the manufacture, import and distribution of a consumer product must be maintained for six years, and must be provided to Health Canada on request.

Penalties for breach of the CCPSA include fines up to \$5 million and/or prison terms of up to 2 years.

Proposed Amendments to Alberta Personal Information Protection Act

Alberta's Bill 54, which came into force on May 1, 2010, fine tunes the Alberta Personal Information Protection Act ("PIPA"), which regulates how private sector organizations collect, use, disclose, protect and provide access to personal information. As a result of the amendments to PIPA prescribed by Bill 54, organizations operating in the Alberta private sector will now have to comply with more stringent privacy requirements. In this article we will briefly discuss the nature of the amendments made to PIPA and how such changes impact the franchise industry.

The provisions of Bill 54 expand the definition of "personal employee information" to include information about a former employee as well as information used for managing a post-employment relationship, providing for more consistent standards of handling personal information of employees. The compliance obligations under PIPA regarding information which is collected, used and disclosed by both franchisors and franchisees is thus broadened to include such information about prior employees (which includes, directors, officers, volunteers and contractors or agents providing services) and post-employment related information.

Other legislative changes made as a consequence of Bill 54 include:

- Organizations now have a positive obligation to destroy or anonymize personal information once the organization no longer requires it for legal or legitimate business purposes.
- The ambit of penalties for noncompliance has been widened as the "wilful" requirement has been removed such that an organization could commit an offence even if it acted unintentionally.

Perhaps the most important amendments made to PIPA are the following new notification provisions.

Transferring Personal Information Outside Canada

Organizations are now required to (1) notify individuals when they will be transferring individuals' personal information to a service provider outside Canada, and (2) include information regarding this outsourcing practice in the organization's policies and practices. These changes are particularly relevant for both franchisors and franchisees who are part of a systems which is controlled or managed by a foreign parent company and transfer personal information to that parent company about their respective franchisees, employees, directors, officers and other agents. In addition, any franchisors or franchisees that utilize service providers located outside of Canada will need to remain cognizant of, and compliant with, such new notification provisions. It should be noted that this new notification requirement is in addition to the requirement to notify individuals about the purposes of the collection of their personal information and to provide contact information for someone who can answer any questions.

Personal Information Lost, Accessed or Disclosed without Authorization

The new notification provisions also require organizations to notify the Privacy Commissioner of Alberta if personal information under the organization's control is lost, accessed or disclosed without authorization in circumstances "where a reasonable person would consider that there exists a real risk of significant harm to an individual", thus making Alberta the first Canadian jurisdiction to require mandatory security breach notification. Once notified, the Commissioner will review the information provided by the organization and determine whether affected individuals need to also be notified of the security breach in order to allow the individuals to take steps to reduce their risk of harm, or the extent of the harm, if possible.

In response to the amendments both franchisors and franchisees should take the following steps:

(1) Consider whether any foreign entities - including service providers, parent corporations and other affiliated organizations within the franchise systems - receive, store or have access to "personal information" or "personal employee information" that is subject to PIPA. If so, review the policies and practices surrounding the transfer of information and update them to incorporate the requisite information and notification requirements.

(2) Incorporate in its privacy breach protocol a step to notify the Privacy Commissioner of any serious security breach.

(3) Review current policies with respect to collecting, using or disclosing personal employee information after the employee leaves the organization.

(4) Revise record retention and destruction policies and procedures, so that personal information is destroyed or "anonymized" once no longer required.

Proposed Amendments to Federal Privacy Legislation

On May 25th, 2010, the Federal Government of Canada announced proposed amendments to the Personal Information Protection and Electronics Act ("PIPEDA") in Bill C-29 to address public concern about the increasing number of data breaches involving personal information. Bill C-29 is currently at the first reading stage in the House of Commons.

Significant changes proposed by Bill C-29 include a new requirement under PIPEDA for federally regulated organizations to report all material data breaches to the Privacy Commissioner of Canada and to notify individuals where the breach poses a real risk of "significant harm", such as identity theft or fraud, or damage to the individual's reputation. "Significant harm" includes bodily harm, humiliation, damage to reputation or relationships, loss of employment, business or professional opportunities, financial loss, identity theft, negative effects on a credit record, and damage to or loss of property. Bill C-29 also addresses how the private sector deals with demands by governmental agencies for customer information; the proposed amendments would make it clear that organizations may collaborate with government institutions (such as law enforcement and security agencies that have requested personal information) in the absence of a warrant, subpoena or order if the institution or agency has lawful authority to request the information. Furthermore, a new provision would prohibit organizations from notifying individuals about the disclosure of personal information to law enforcement and security agencies where the government institution to whom the information was disclosed objects to the notification in order to prevent jeopardizing investigations.

Bill C-29 also proposes the addition of new exceptions to the requirement of consent for the collection, use and disclosure of personal information. Examples of when federally regulated organizations would be allowed to collect, use and disclose information without the consent of the individual employee include the following:

- Where it is necessary to establish, manage or terminate an employment relationship, provided that the employee be given notice of the purpose for which their information will be collected, used and disclosed.
- Where the information is produced by individuals in the course of their employment, business or profession (work product) provided the collection, use and disclosure of the information is consistent with the purposes for which the information was produced.
- The disclosure of information by one organization to another organization where the disclosure is necessary to investigate a breach of an agreement, a contravention of the laws of Canada or a province, or the information is disclosed to prevent, detect, or suppress fraud when it is reasonable to expect that the knowledge or consent of the individual to such disclosure would undermine the ability to prevent, detect, or suppress the fraud.

In addition, Bill C-29 proposed to expand the definition of "business contact information" to include an individual's work email address and other business contact information in addition to their name, position name or title, work address, work telephone, and work fax numbers. Business contact information will not be subject to the consent rules contained in PIPEDA provided it is collected, used or disclosed solely for the purpose of communication with the individual in relation to their employment, business or profession.

British Columbia and Ontario Move to Harmonized Sales Tax Regime

The Provinces of British Columbia and Ontario replaced their respective provincial sales taxes (the social services tax in British Columbia and the retail sales tax in Ontario) with a Harmonized Sales Tax ("HST") that displaced the previous federal Goods and Services Tax ("GST") effective July 1, 2010.

The HST rate is 12% in British Columbia and 13% in Ontario. Like the previous 5% GST, the HST is administered by the Canada Revenue Agency and imposed under the Excise Tax Act (Canada).

The HST is the same as the HST that has been in place in New Brunswick, Nova Scotia, and Newfoundland and Labrador since those Provinces harmonized with the GST in April 1997.

The change from a provincial sales tax to a multi-stage value added tax in the form of the HST should benefit many businesses. It allows businesses to comply with one transaction tax, rather than two, saving millions of dollars in compliance costs for business and in administration costs for the Ontario and British Columbia governments.

Most businesses that previously made GST taxable supplies or that had supplied goods or services on a GST zero-rated basis, including franchisors that collect GST on initial franchise fees and royalty fees, are entitled to recover the higher HST that they pay on inputs into their businesses. They no longer have to pay unrecoverable provincial sales taxes on purchases of goods and taxable services.

However, some aspects of the new HST are potentially costly to certain medium and large-sized businesses. All businesses that make more than \$10 million in GST/HST taxable sales are unable to claim input tax credits to recover the previous Provincial portion (8% in Ontario, 7% in British Columbia) of the 13% HST payable on a limited range of inputs that would otherwise be creditable. These include energy, along with telecommunications services (other than internet access or toll-free numbers), road vehicles under 3,000 kg (including parts, services and fuel), food, beverages and entertainment.

The exemption from Ontario provincial sales tax for prepared foods at \$4.00 or less that existing previously has been carried forward under the new HST regime in Ontario. No such exemption exists in British Columbia.

The most common compliance issue for businesses operating in more than one province is determining the correct province of supply. The difference in HST rates of 12% in British Columbia, 13% in Ontario, New Brunswick, Nova Scotia and Newfoundland, the 5% GST rate in the rest of Canada, as well as the 7.5% Quebec Sales Tax rate in Quebec, will make these determinations very relevant.

6. Canadian Case Law Update: 2010-2011

578115 Ontario Inc. v. Sears Canada Inc.

In 578115 Ontario Inc. v. Sears Canada Inc. the plaintiff franchisee operating as “McKee’s Carpet Zone” started a proposed class action on behalf of 73 retailers operating Sears Floor Covering Centres. The principle allegation was that the Sears Floor Covering Centre retailers did not know that they were receiving only a portion of the rebate paid by suppliers to Sears. The franchisee was claiming damages based on what it felt were “secret rebates” received by Sears. The plaintiffs in the Sears case base their claim in breach of contract; breach of the implied contractual and statutory duty of fair dealing; and breach of the s. 5 of the Ontario Act (the duty to disclose).

The Ontario Regulation under the Ontario Act only requires a franchisor to disclose the franchisor's policy, if any, regarding volume rebates and whether or not the franchisor or the franchisor's associate receives a rebate, commission, payment or other benefit as a result of purchases of goods and services by a franchisee and, if so, whether rebates, commissions, payments or other benefits are shared with franchisees directly or indirectly.

Justice Strathy only had to decide whether or not to certify the class action and allow it to proceed (and therefore was not making any judgment on the merits of the plaintiff’s position). Sears opposed the certification on the grounds that some of the claims could only be resolved through individual trials and were not therefore suitable for a class proceeding.

Justice Strathy disagreed with Sears position and certified the class action against Sears Canada for its alleged failure to properly disclose its policy regarding volume rebates from suppliers. He felt that while individual trials might be required, judicial economy and access to justice would be attained through proceeding as a class action.

As a result of the Sears Canada class action certification, franchisors should examine their disclosure documents and consider what disclosure they are providing regarding rebate practices.

Similar class proceeding have been certified in *Pet Valu (1250264 Ontario Inc. v. Pet Valu Canada Inc.)* and in the *Quiznos* decision (*Quizno's Canada Restaurant Corporation et. al. v. 2038724 Ontario Ltd. et. al.*)

In the *Quiznos* decision, the Ontario Court of Appeal dismissed *Quizno's* appeal, upholding the Divisional Court's decision to certify the proceeding as a class action. The Court held that there were common issues regarding an alleged price maintenance scheme in breach of the Competition Act, a claim for conspiracy (as between *Quizno's* and *Gordon Food Services*, the franchise system's supplier) and breach of the franchise agreements, the latter of which required the franchisor to provide its franchisees with supplies and products at "commercially reasonable prices".

The Court disagreed with the appellants' counsel's argument that the individual issues would "overwhelm" the common ones:

"[61] The trial of the common issues in this case will significantly advance the litigation. I agree with the conclusion of the Divisional Court majority that this is the case even if the damages issues cannot be dealt with on a class wide basis."

405341 Ontario Limited v Midas Canada Inc.

In perhaps the most surprising decision of 2010, the Court of Appeal dismissed the appeal of *Midas Canada Inc.* from the lower court decision of Justice Cullity dated October 16, 2009.

Justice Cullity held that the provisions of the *Midas Franchise and Trademark Agreement* that required franchisees to sign a release in favour of *Midas* on the renewal or assignment of their franchise agreement were void under s. 11 of the *Arthur Wishart Act (Franchise Disclosure) 2000* (the "Act"). Section 11 provides that "Any purported waiver or release by a franchisee of a right given under this Act or of an obligation or requirement imposed on a franchisor or franchisor's associate by or under this Act is void". Justice Cullity restricted his ruling to this proceeding (and thus to agreements where the franchisees are members of the class within this proceeding).

The Court distinguished the case from the *Tutor Time* decision holding that it "has no application to the facts of this case". [24] "...In the present case, the release that would be part of the extension agreement derives from ss. 9.3 and 7.4 (f) of the Agreement. Thus, this is not a situation analogous to *Tutor Time* [where releases were signed in respect of existing claims with the benefit of independent legal advice]. The Agreement was signed prior to the claims arising and, therefore, without full knowledge of the breaches."

The directive of the Court was this: "[26] The language of s. 11 could not be clearer. If you include a term in your franchise agreement that purports to be a waiver or release of any rights a franchisee has under the Act, it will be void."

As the Court wrote at para. [29] and [30] of its reasons:

[29] Requiring a franchisee to sign a release in order to renew or assign the franchise agreement "is simply contrary to the spirit, intent and letter of the Act. Where a franchisor insists upon such waiver or release, s. 11 makes it clear that any such waiver or release will be void".

[30] "The purpose of the Act is to protect franchisees. The provisions of the Act are to be interpreted in that light. Requiring franchisees to give up any claims they may have against a franchisor for purported breaches of the Act in order to renew their franchise agreement, unequivocally runs afoul of the Act."

The Court also held that the provisions of the agreement requiring that a release be provided on renewal and assignment of the agreement violated rights of association under s. 4 of the Act and that by contracting into the law of Ontario, the Ontario Act applied to the relationship between Midas and its franchisees across Canada, notwithstanding the fact that the Ontario Act applies only to businesses operated partly or wholly within the Province of Ontario. This finding took franchise practitioners in Canada by surprise. As a result, it is felt that it is very difficult to predict what the courts will do next when interpreting provincial franchise legislation.

The message to franchisors across Canada is to take a look at your agreements and consider the choice of law provisions in them. Adopting a law in a jurisdiction with franchise legislation will likely prevent a franchisor from obtaining a full release on renewal or assignment of the agreement. Adopting a law other than the law of the province in which the franchisee carries on business may also be offside the franchise legislation in that province (where such legislation exists) as the legislation in Ontario, PEI, Alberta, New Brunswick (and soon Manitoba) uniformly provides that parties to a franchise agreement may not restrict the law of that province with respect to a claim otherwise enforceable under that legislation.

Franchisors may want to seriously consider whether they want to include renewal provisions at all, given that they will not be able to secure a release of statutory claims on renewal. If they do include renewal provisions and should they impose a condition requiring a release to be signed on renewal, they must ensure that the release is restricted to non-statutory claims as otherwise the entire provision will be void.

TA & K Enterprises Inc. v. Suncor Energy Products Inc. and Suncor Energy Inc.

A decision of Ontario's Superior Court of Justice, released December 17, 2010, granted summary judgment to a franchisor, ruling that it was entitled to rely on an exemption from the statutory requirement to deliver a disclosure document.

In *TA & K Enterprises Inc. v. Suncor Energy Products Inc. and Suncor Energy Inc.*, the plaintiff franchisee claimed, in a class proceeding, that Suncor had breached the Ontario Act for failure to deliver a disclosure document. It claimed that the 241 class members, each of whom operated a retail gas station in Ontario, were entitled to the remedy of rescission under the Act for Suncor's breach and claimed aggregate damages in the amount \$200 million.

The Court granted Suncor's motion for summary judgment on the basis that Suncor was exempt from the obligation to deliver a disclosure document, under section 5(7)(g)(ii) of the Act, because the franchise agreement was: (i) for less than one year; and (ii) the agreement did not involve payment of a non-refundable franchise fee.

In considering the meaning of “franchise fee”, which is not a defined term in the Ontario Act, the Court looked at the definition of that term in Alberta’s franchise legislation. Mr. Justice Perell held that a franchise fee is akin to an initiation fee or key money. He held that a franchise fee, for purposes of the exemption, is “a fee paid for the right to be a member of the franchise chain”. He also held that it was not the intention of the legislature that every payment by a franchisee is a franchise fee for purposes of section 5(7)(g)(ii) of the Ontario Act. He distinguished between royalty fees and an initial franchise fee, stating:

I think the Alberta definition, which is, in part, a definition by exclusion, offers a better understanding of what was intended by the Ontario Act’s reference to a franchise fee. In my view, a franchise fee it is not a payment for goods or services and it is not a payment for royalties or similar fees payable under the franchise agreement. In my opinion, a franchise fee under s. 5 (7)(g)(ii) is essentially a fee paid for the right to be a member of a franchise chain.

In holding that the franchise agreement was not valid for more than one year, the Court found that the legislature intended there to be exceptions to a franchisor’s disclosure obligations. The operative period for determining whether the agreement is valid for longer than one year is the term under which the rights and obligations of the parties under the agreement were enforceable. Notwithstanding that the plaintiff signed the franchise agreement on November 11, 2008, Justice Perell held that the plaintiff had enforceable rights under the agreement only from November 15, 2008 to November 14, 2009, being less than one year. Further, notwithstanding that the agreement allowed for a month to month extension, at the option of Suncor, and that in fact Suncor did extend the term, the availability of the exemption under section 5(7)(g)(ii) was not affected. In order to avail oneself of this exemption, regard must be had to term of enforceable rights at the time that the agreement is entered into and not to any extension which results in the term being greater than 1 year for purposes of determining whether a disclosure document should be provided. In Justice Perell’s opinion, it was not the intention of the legislature “to make a prospective obligation to provide a disclosure document to operate retroactively, and thereby, make conduct illegal that was proper at the time it occurred.”

The Court also suggested that exemption from disclosure under section 5(7)(f) of the Ontario Act (for renewal or extension of a franchise agreement) may also be available to the defendants but whether there was a material change since the franchise agreement was entered into raised a genuine issue for trial which could not be determined on the motion. The Court suggested that the benefit of this exemption was not lost merely by reason of the fact that the parties entered into a new franchise agreement upon renewal. In his reasons, Justice Perell wrote that any new agreement between the parties, be it a new agreement to replace the old or be it a new agreement to extend the old, would satisfy the requirement of section 5(7)(f) that there be a pre-existing agreement under which the parties operated. In other words, so long as there was a pre-existing relationship between the parties, disclosure would not be required unless there was either an interruption in the operation of the business or there was a material change to the former arrangement.

This is the first decision on the interpretation of the Ontario Act exemption that disclosure is not required where the franchise agreement is not valid for longer than one year.

Di Stefano v. Energy Automated Systems Inc.,

Di Stefano v. Energy Automated Systems Inc., 2010 ONSC 493, involved a motion by the corporate defendant EASI and two of the individual defendants to stay an action brought by 10 individuals who claimed to be franchisees under agreements they signed with EASI. The plaintiffs further claimed that EASI failed to make the disclosure required by the *Wishart Act* and made false representations. The plaintiffs sued for various types of relief, including rescission of the agreements, a

refund of purchase monies paid, a return of and reimbursement for any remaining inventory and equipment and compensation for any losses they suffered.

EASI was a Tennessee corporation. The two individual moving party defendants were residents of Tennessee. The motion was framed under both Rule 21.01 and Rule 17.06 of the *Rules of Civil Procedure*. However, it proceeded essentially as a motion for a stay of proceedings under Rule 17.06. The primary ground for the motion was a forum selection and governing law provision in favour of Tennessee contained in the agreements between several of the plaintiffs and EASI. The plaintiffs argued that the proper construction of the relationship with EASI was that of franchisee and franchisor. If that construction was correct and the agreements were in fact franchise agreements, s. 10 of the Ontario Act would apply rendering the forum selection clauses void. The upshot of the argument was that Ontario was the proper forum.

Although there was disagreement as to whether the court could receive affidavit evidence on the motion, Justice Code found that a preliminary but central issue, whether or not the plaintiffs were franchisees, had to be determined before any adjudication could be made on the application for a stay. The court concluded that it could entertain affidavit evidence to decide the preliminary issue.

The particular question to be answered was whether or not the business relationships fit into the business format portion of the definition of "franchise" contained in s. 1(1) of the Ontario Act. The court listed three elements to the statutory test to be met:

- "the franchisee is required by contract ... to make a payment or continuing payments ... to the franchisor ... as a condition of acquiring the franchise or commencing operations";
- "the franchisor grants the franchisee the right to sell ... goods or services that are substantially associated with the franchisor's ... trademark";
- "the franchisor ... exercises significant control over, or offers significant assistance in, the franchisee's method of operation, including building design and furnishings, locations, business organization, marketing techniques or training".

As to the evidence on the motion, Justice Code appears to have accepted the following assertions made by the moving parties:

- Two of the Plaintiffs ... never contracted with EASI. They simply work for EASI dealerships;
- The other eight Plaintiffs did contract with EASI. Four of them signed "Reseller Agreements" and four of them signed "Dealer Agreements";
- All eight contracts were negotiated entirely in Tennessee. The eight Plaintiffs would all have travelled to Tennessee, completed a five-day training program at EASI's training facility in Tennessee, paid the requisite fee and then signed their contracts, all in Tennessee;
- The eight contracts all contain forum selection and governing law clauses to the same effect: that "any claim ... shall be brought in Sumner County, Tennessee" or "sole jurisdiction and venue for actions related to the subject matter hereof shall be the State of Tennessee"; and, "this agreement shall be construed and enforced in accordance with laws of the State of Tennessee" or "this agreement is governed by Tennessee law";

- EASI is a Tennessee corporation, it has never maintained offices in Canada and its principals, Merlo and Bleiweiss, have never travelled to Ontario;
- EASI's various employees, who may have relevant evidence about any of the contractual negotiations and representations are all Tennessee residents and all of EASI's business records are located in Tennessee;
- The five-day training program is free for the first day. If trainees are interested in proceeding further, they must sign a dealership agreement, pay the requisite fee (which is \$30,000 in some cases and \$40,000 in some cases) and complete the training program;
- EASI's business is the sale and distribution of equipment "designed to reduce the volume of electricity consumed by electric motors, lighting equipment, air conditioning and other electric-powered devices used primarily in commercial facilities". Accordingly, the training program is designed to educate prospective dealers "on the energy conservation industry and equip them to operate their own independent business in that industry. EASI employs electricians and engineers to assist in this training process. Each new EASI dealer departs training with textbooks, a copy of the training manual, sample products and demonstration equipment ... [A] dealer must know how to review a prospective customer's entire electricity demand (e.g. lighting, refrigeration, HVAC, computer equipment, electrical motors, etc.), list the technical specifications of each electrical load, evaluate whether the facility would benefit from energy conservation products, and oversee the delivery and installation of often hundreds of specific product treatments designed to result in energy savings".

The plaintiffs on the other hand filed only one affidavit, which appended the Statement of Claim but which did not respond to or dispute the main factual contentions of the moving parties set out above. With respect to the "significant control" or "significant assistance" aspects of the business format franchise definition, the only facts pleaded by the plaintiffs in the Statement of Claim were that:

- EASI's distributorship agreement is a grant of non-exclusive territory for an initial term of 3 years.
- The distributor is required during the term of the contract to sell only energy conservation products and accessories EASI sells to the distributor.
- As a requirement of the contract, EASI provides the distributor with a (5) day training seminar, and through an independent contract will assist the Dealer in marketing, use and maintenance and installation of the product. However, the distributor bears the cost of this support.

The court concluded, on the basis of the evidence filed, that the agreements with EASI were not franchise agreements and that the plaintiffs were not franchises. In this regard, Justice Code stated:

26 The three part "franchise" test has already been set out above. The first element is "a payment" between the parties. There is no evidence that the Plaintiffs Masterson and Dickson ever made a payment to EASI. As to the other eight Plaintiffs, EASI concedes that they each made substantial payments to EASI related to the five day training course. The second element is "the right to sell ... goods or services that are substantially associated with [EASI's] trademark." Again, there is no evidence Masterson and Dickson ever contracted for this right with EASI. As to the other eight Plaintiffs, EASI concedes that they contracted to sell its products. The third

element is the critical one in the definition. Although the Plaintiffs pleaded both "significant control" and "significant assistance", counsel for the Plaintiffs conceded during argument of the Motion that there is no evidence of "significant control over ... the [Plaintiffs'] method of operation". I agree with this concession. The real issue in the case, and on this Motion, is whether EASI "offers significant assistance in the [Plaintiffs'] manner of operation, including building design and furnishings, locations, business organization, marketing techniques or training." Counsel for the Plaintiffs conceded during argument that the sole basis on which this test can be met is the five day training program, prior to obtaining an EASI dealership.

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

Thus, the Ontario Act had no application to the relationships between the parties. The forum selection and governing law provisions of the agreements were therefore valid and operative. Applying the test for the enforceability of contractual forum selection clauses set out in *Z.I. Pompey Industrie v. ECU-Line N.V.* (2003), 224 D.L.R. (4th) 577 (S.C.C.), the court held that the plaintiffs had failed to show a strong cause or exceptional circumstances that would permit them to avoid those provisions. The court also found that the traditional *forum non conveniens* analysis favoured Tennessee as the appropriate forum. Accordingly, the action was stayed with costs.

The EASI case is important in that it is one of the few reported decisions in which the Ontario courts have tackled head on the definition of "franchise" contained in s. 1(1) of the Ontario Act. The approach taken by Justice Code might foreshadow how the courts will address the issue in the future – rather than determining precisely what amounts to "substantial association", "significant control" or "significant assistance", it might be simpler and more in keeping with the remedial nature of the *Act* to decide what, in any given case is just not substantial or significant enough for the purposes of the definition.

Seidel v. Telus Communications Inc.

The March 18, 2011 decision of the Supreme Court of Canada in *Seidel v. Telus Communications Inc.* clarifies the state of the law regarding arbitration clauses in "contracts of adhesion". These are standard form contracts drafted by manufacturers or providers of goods and services and signed by customers without negotiation and usually without even being read. The arbitration clauses in such contracts typically provide that in the event of a dispute, the parties (in particular, the consumers) agree to submit their dispute to arbitration rather than to the courts. Such clauses have become commonplace. Manufacturers and service providers increasingly rely on them as a means of ousting motions for certification of class actions related to their products.

In recent prior rulings, the Supreme Court of Canada had upheld the enforceability of arbitration clauses in standard form contracts of adhesion. However legislatures in many provinces enacted laws to invalidate these arbitration clauses thereby allowing consumers to pursue class proceedings. Also lower courts in several provinces sought to circumscribe the ambit of the prior Supreme Court decisions by working to invalidate arbitration clauses where they would prevent consumers from pursuing class proceedings.

In the *Seidel v Telus* case, the Supreme Court of Canada reviewed consumer protection legislation in British Columbia, which provides consumers with statutory causes of action in respect of violations of that province's *Business Practices and Consumer Protection Act*, and which contains specific language invalidating arbitration clauses. The arbitration clause at issue purported to waive the consumer's right to bring any court proceeding, including class actions under the *Business Practices and Consumer Protection Act*, in favour of arbitration. In a narrow 5 to 4 ruling, the Supreme Court of Canada found that such legislation was enforceable to invalidate an arbitration or waiver of class action clause in consumer contracts of adhesion. Absent such a prohibition however, such clauses remain *prima facie* enforceable.

This decision is in keeping with the general Canadian policy trend that favours access to justice issues in considering class actions, forum and procedure.