

1. Franchises Act (BC) – In Force February 1, 2017

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Franchise regulation has arrived in British Columbia. The new BC *Franchises Act* (the “**BC Act**” or simply the “**Act**”) and regulations to it (the “**BC Regs**” or simply the “**Regs**”) came into force on February 1, 2017.

This article will provide franchisors, accountants, consultants and bankers with important details on how to comply with BC’s new franchise legislation.

To begin, I will give you my experience dealing with franchising and franchise legislation. I have practiced in the field of franchising continuously since 1985. From 2005 to 2013, I practiced franchise law in Toronto, where I prepared franchise disclosure documents and upgraded existing franchise agreements for Canadian and American Franchisors. I also acted as a Director, Secretary and General Counsel to the Canadian Franchise Association (“CFA”) for 4 of those years.

I will now begin by reviewing the main provisions of the BC Act. After that, I will review the main sections of the BC Regs, which mandate the contents of franchise disclosure documents (“**FDDs**”).

The BC Act and Regs contain more details than I will be able to provide in this paper. Please feel free to contact me if I fail to discuss something about the Act or Regs that you may have questions about. (My contact details appear at the end of this paper.)

2. New BC Act – Key Sections

In my view, the following are the key sections of the new BC Act:

Section 1 contains important definitions, including “**franchise**”, “**franchise agreement**”, and “**material fact**”.

“**franchise**”. Any agreement, whether named as a “license agreement”, “joint venture agreement” or otherwise, which meets the Act’s three-fold test of a “franchise”, will be deemed to be a “franchise” and will be subject to the Act. The three-fold test of a “franchise” is:

1. the Franchisor grants the franchisee the right to engage in a business, for which the franchisee pays an initial fee;

2. the franchisee's right to sell goods or services (or both) is substantially associated with the Franchisor's trade-mark; and
3. The Franchisor exercises significant control over the franchisee's method of operation.

[While a distribution of goods arrangement may be deemed to be a "franchise" by the Act, it is not discussed here. This paper focuses on 'business format franchising'.]

"franchise agreement" – Any agreement that "relates to a franchise" is deemed by the Act to be a "franchise agreement". Accordingly, leases, subleases, area development agreements, master franchise agreements, guarantees and indemnities will all be included in this definition.

"Material Fact". A material fact is defined as any information about a franchised business that would reasonably be expected to: (a) have a significant effect on the price of the franchise; or (b) affect a decision to acquire a franchise. Since this test is broad, it will sometimes be difficult for a Franchisor to decide whether specific information is or is not a "material fact" requiring disclosure in a franchise disclosure document.

NOTE: As a tool for interpreting the BC Act and Regs, there is obviously not yet a body of case law to use. It is very likely that the BC courts will initially apply case law from Ontario, which has similar franchise legislation named the *Arthur Wishart Act* (the "**Ontario Act**" or "**Wishart**"). The Ontario Act has been in force since 2000 and a substantial body of case law surrounding it has developed in Ontario in the meantime.

Section 2 (Application). This section confirms that the BC Act applies both to a new and a renewal franchise agreement for any location wholly or partially within BC.

Section 3 is very important. It imposes a "duty of fair dealing" [which] includes the duty to act in good faith and in accordance with reasonable commercial standards". Although this duty is placed on both Franchisors and franchisees, the Ontario Court of Appeal in a case known as *Midas* (2010) has stated that: "The purpose of the Act [Wishart] is to protect franchisees ... the provisions of the Act are to be interpreted in that light." Further, a year earlier, the same Ontario Court stated that the Franchisor's ability to exercise its sole discretion in a matter cannot be applied to taking any action that is against "the express rules as well as the spirit, letter and intent of the Act." In deciding whether the statutory duty of "fair dealing" has been met by a Franchisor, courts have examined both the wording of the franchise agreement involved and the conduct of the Franchisor, often giving equal weight to both.

Section 4 gives franchisees the right to associate with each other. This includes the right to deal as a group with their Franchisor. A Franchisor cannot refuse to deal with such a group. The same type of provision in Ontario has been used successfully by franchisees to maintain class actions against their Franchisors.

Section 5 refers to delivery of FDDs, a topic I will deal under the "Regulations" heading below.

Section 6 gives a franchisee a right of rescission (termination) if improper disclosure takes place. See more under the "Regulations" heading below.

Section 7 gives a franchisee the right to claim monetary and other compensation resulting from the franchisee being misled by a misrepresentation in a franchise disclosure document. Discussed further below under “Regulations”.

Section 8 provides the Franchisor with a defence to a franchisee’s suit for misrepresentation and damages if the Franchisor can prove that the franchisee had actual knowledge of the misrepresentation before signing a franchise agreement; the section provides other defences too.

Section 9 allows an imperfect FDD to be saved if it merely contains “a defect in form, a technical irregularity or an error ... [which] does not affect the substance of the disclosure document.” This section may prove helpful in appropriate cases.

Section 10 imposes joint and several liability on the Franchisor and the two directors/officers of the Franchisor who sign the mandatory Certificate of Franchisor. The Certificate requirement is discussed further below under “Regulations”.

Sections 12 and 13 do not allow a franchisee to waive any of its rights under the Act or any other laws of BC (except in the case of a negotiated settlement with its Franchisor) or to waive its right to a hearing by a BC court or a BC arbitrator in respect of a dispute with its Franchisor.

3. Requirements of a Franchise Disclosure Document (“FDD”)

The Key Contents of BC’s Regulations

The Regulations provide mandatory contents for FDDs; they do not provide a mandatory form, so the lawyer for a Franchisor must develop his/her own form.

By section 5 of the Act, a FDD must be written by the Franchisor “accurately, clearly and concisely”. Therefore, any ambiguity in drafting the FDD must be avoided.

The BC Regulations require each FDD to disclose/provide the following:

- Mandatory “risk warnings” to the franchisee, under **section 3**, to investigate thoroughly before investing in the franchise being offered. For example, franchisees are to be advised to seek independent legal and financial advice and information about the Franchisor and its history, in addition to what is contained in a FDD.
- Business background information about the Franchisor, pursuant to **Schedule, Part 1, s. 1**, including its name, incorporation details, any parent or affiliate, its principal address and business name, its business experience, including any previous offering of franchises, as well as the following details about the **Franchisor’s directors and officers**:
 - Their names and current positions with the Franchisor. (**Schedule, Part 1, s. 2**).
 - Their prior relevant business experience. **Schedule, Part 1, s. 2**).
 - Their employers during the past 5 years. . **Schedule, Part 1, s. 2**).
 - Whether, during the past 10 years, there has been any conviction (or charge pending) for fraud, unfair or deceptive business practices or a breach of any law that regulates franchises or other businesses. (**Schedule, Part 1, s. 3**).

- Whether, during the past 10 years, there has been any existing or pending administrative order or penalty under a law that regulates franchising made against any director or officer, the Franchisor or its associate. (***Schedule, Part 1, s. 4***).
- Whether, during the past 10 years, there has been any liability found under a civil judgment or there is a pending claim for misrepresentation, unfair or deceptive business practices or violation of a law that regulates franchising or business (***Schedule, Part 1, s. 5***).
- Whether, during the past 6 years, there has been any bankruptcy proceeding involving the Franchisor, its associate or any of their directors or officers, or any corporation of which a current director or officer was a director or officer of the other corporation. (***Schedule, Part 1, s. 6***).
- Financial statements of the Franchisor for its most recently completed financial year, which must be audited or prepared on a 'review engagement' basis. The statements must be prepared in accordance with standards set forth in the *CPA Canada Handbook* or set by the *International Auditing and Assurance Standards Board*. (***5***).
- Whether, as a policy of the Franchisor, guarantees by the principals of a corporate franchisee or security by the franchisee will be required (***Schedule, Part 2, s. 9***).
- Trade-marks, either registered or pending, which are owned or licensed by the Franchisor and used in the franchise system must be disclosed in detail, as must the right of the Franchisor itself to use the marks and to license or sublicense them to the franchisee (***Schedule, Part 2, s. 19***).
- All federal and provincial laws relating to the franchise must be disclosed. With regard to requirements of the municipality where the franchisee will open, the FDD merely needs to state that the franchisee is advised to make inquiries regarding licencing, registrations, authorizations and other permissions with the municipal hall. (***Schedule, Part 2, s. 20***).
- If a Franchisor makes any misrepresentation in its FDD, then **section 7 of the Act** gives any franchisee suffering a loss thereby the right to claim damages against the Franchisor (and the two directors or officers signing a Certificate of Franchisor – see above). **Section 8 of the Act** provides potential defences to a Franchisor.
- The Franchisor must disclose details of its training program for new or renewing franchisees and any related costs to be paid by them (for example, any training fee and the cost of airfare, accommodation and meals if the franchisee must travel to take training) (***Schedule, Part 2, s. 13***).
- Whether a personal franchisee or the principal(s) of a corporate franchisee must personally participate in management of the franchised business (***Schedule, Part 2, s. 21***).
- The grant of any "territorial rights" around the approved location of the franchisee. If granted, any conditions imposed on the franchisee on continuation (or potential alteration or reduction) of the territorial rights. If no territorial rights are to be granted, then a statement to that effect. (***Schedule, Part 2, s. 18***).
- If the Franchisor is reserving the right to distribute franchise specific goods through 'alternate channels of distribution', such as via the internet or

supermarkets located in the franchisee's protected territory, then this must be disclosed (***Schedule, Part 2, s. 18(1)(b)***).

- The Franchisor's advertising program must be detailed, including contributions to an advertising fund which franchisees are required to make [often 2% of gross sales], ways in which fund proceeds may be expended by the Franchisor and regular reporting on fund activities by the Franchisor (***Schedule, Part 2, s. 15***).
- The Franchisor must state the deposits and fees payable by the franchisee and provide reasonable estimates of the capital costs required to construct/renovate the franchise location. Where appropriate, a range for some costs (for example, between \$X and \$Y) will be acceptable (***Schedule, Part 2, s. 7***).
- The Franchisor need not provide an estimate of the annual operating costs of the franchise. However, if it decides to do so, I often recommend that (as a way to help minimize potential liability of the Franchisor for a misrepresentation), the Franchisor provide three columns of estimated operating costs, marked "Low", "Medium" and "High", rather than giving a single set of figures. If the Franchisor does provide an estimate or estimates, it must also disclose reasonable assumptions and bases for the estimates or the place where information substantiating the estimates will be available for inspection by the franchisee. If the Franchisor is not providing any such estimates, then it must state this. (***Schedule, Part 2, s. 10***).
- If the Franchisor is providing an "earnings projection" (whether directly in its FDD or separately through sales literature), it must state the assumptions and bases for the projection, whether the projection is based on actual results of franchisees or results of the franchisor or its affiliate and where information substantiating the projection is available for inspection by the franchisee. If no earnings projection is provided, the FDD must state this fact. (***Schedule, Part 2, s. 11***).
- The Franchisor's policies and practices regarding collection and use of "rebates" or "other payments" from suppliers, on purchases of inventory or other goods or services, must be specified. Will the Franchisor keep all rebates for itself or will it share them, in some way(s), with its franchisees? (***Schedule, Part 2, s. 17***).
- Whether the Franchisor is providing an operations manual (either in hard copy or online), for ongoing guidance of the franchisee. The Franchisor must either attach a table of contents of its manual to the FDD or specify where the manual will be available for inspection by the franchisee (***Schedule, Part 2, s. 14***).
- Details regarding any goods or services the Franchisee must purchase or lease from the Franchisor, its affiliate or its approved suppliers, and to whom it must sell them. (***Schedule, Part 2, s.16***).
- As mentioned, **section 9 of the Act** permits "substantial compliance" by an FDD or SMC; note, however, this section is only meant to cover accidental errors or omissions which are not substantive.
- Conditions related to termination, renewal or transfer of the franchise must all be specified (***Schedule, Part 2, s. 22***).
- Restrictions or requirements on the purchase or lease of goods and services by the franchisee from the Franchisor, its affiliate or designate, and on future sales of

such goods or services by the franchisee to particular classes of purchasers must be specified (*Schedule, Part 2, s. 16*).

- A description of any restrictions or requirements in the franchise agreement regarding arbitration or mediation must be included in the FDD. (**4**). However, a franchise agreement need not require arbitration or mediation in its franchise agreement.
- A list of current franchisees must be provided. The list must include names and last available business addresses and telephone numbers [to allow prospective or renewing franchisees to contact current franchisees to ask pertinent questions, as a key part of ‘due diligence’ (*Schedule, Part 2, ss. 23-25*).
- Also, a list of any franchise closures (terminations, non-renewals and reacquisitions) during the previous 3 fiscal years of the Franchisor must be included, along with contact information, again for ‘due diligence’ by the prospective or renewing franchisee (*Schedule, Part 3, s. 26*).
- If a “material change” in the franchise system or FDD occurs within the 14 day disclosure period, then the Franchisor must immediately deliver a written **Statement of Material Change** (“SMC”) to the prospective or renewing franchisee (**5(6) of the Act**).
- **Certificate of Franchisor:** Two persons, each of whom is a director or officer of the Franchisor, must sign a Certificate of Franchisor by which they certify that all information contained in the FDD (or SMC) is correct and complies with the BC Act and Regs. If any misrepresentation is found in the FDD, the two signatories and the Franchisor will be jointly and severally liable to the Franchisee for any loss or damage it may have suffered. (**s. 2(2), Regs. and s. 7, Act**).
- Unlike the US, there is no mandatory form of FDD. Instead, the drafting of a FDD is the sole responsibility of the Franchisor, with its lawyer, to create.
- A Franchisor which already has a FDD may, by an addendum, amendment or rider, ‘wrap around’ its existing FDD to disclose additional or amended matters required by the BC Act and Regs. However, if a multitude of matters need to be added or amended to ensure compliance and ensure clarity as well, it may be advisable to make changes directly to the Franchisor’s existing FDD (or create a new one) rather than trying to create a separate wrap around document (**2(3)**).
- The FDD must disclose all “material facts” (see above definition) concerning the franchise offering, not just those listed in the Act and Regulations. (**5(5) of the Act**). It will often prove difficult for the Franchisor to determine everything that could be a material fact under the definition.
- **Delivery of an FDD:** By subsection **5(1), Act**, a Franchisor must deliver a FDD to a prospective or renewing franchisee at least 14 clear days before the signing of a franchise agreement. By **5 (2), Act and s. 8 of the Regs**, the FDD may be delivered personally, by prepaid courier or by email. Emailing is a novel feature of the BC Regs – subsection 8 (1)(b) provides specific conditions for delivery by email.

Section 6(2) of the Act could prove extremely costly to a Franchisor which fails to deliver a FDD to a franchisee. If there is a failure to deliver, the franchisee will have 2 full years after signing the franchise agreement to rescind (terminate) it, to claim a refund of all monies paid to the Franchisor and perhaps other relief.

Section 6(1) of the Act also provides that if a Franchisor does deliver a FDD to a franchisee, but the FDD is defective, then the franchisee will have 3 months to rescind the franchise agreement and claim damages. However, the Ontario courts have held that, if a FDD has any substantially material defect (for example, not attaching required financial statements or not delivering a properly signed Franchisor's Certificate), then the FDD may be considered a nullity, giving the franchisee involved a full 2 years after receiving the franchise agreement to rescind. This is not in the Act itself.

Receipt: Finally, the Franchisor must obtain a receipt signed by the prospective or renewing franchisee acknowledging receipt of the FDD on a specified date. The Franchisor must save the receipt as it is a conclusive means of proving delivery.

Additional Matter: Important Current Drafting Issue (Franchisor as “co-employer”)

As you have likely heard, both in the US and Canada, some courts and administrative tribunals have found some Franchisors to be “co-employers” with their franchisees, despite their franchise agreements stating that the two are independent contractors and that the franchisee is entirely responsible for employment matters. In making such a decision, the courts and administrators involved have looked at whether the franchise agreement contains an inordinate number of “control features” – controlling conduct of the Franchisor.

To help Franchisors to avoid a co-employer designation and the extreme impositions it would bring upon them, and, at the same time, to help them comply with the new BC Act (for example, to deal with the “good faith” aspects of it), Franchisors would be wise to review their franchise agreements now with a view to deleting or softening “control features” and providing clarity as to the franchisee having sole responsibility for its employees. These things could be accomplished in an addendum to existing franchise agreements and by revisions to the form of franchise agreement to be used in future. I expect that existing franchisees could agree to signing such an addendum as it would help ensure they could remain in charge of their own employees and, also, have the benefit of softer controls generally.

Effective February 1, 2017, every Franchisor wishing to offer a franchise or renewal franchise in BC must deliver to a prospective or renewing franchisee a FDD which complies with the BC Regs. Since preparation of a FDD takes significant time, I recommend that preparation be started as early as possible. Additionally, most existing franchise agreements will need some amending to comply with the new BC Act.

Special Thanks: The author sincerely thanks Clark Wilson student-at-law, **Brent Grunenberg**,



