British Columbia Becomes the Sixth Province in Canada to Introduce Franchise Legislation

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On October 5, 2015, the Government of British Columbia introduced Bill 38, the *Franchises Act*, for first reading in the legislature. The Bill followed an extensive investigation into the regulation of franchising by the British Columbia Law Institute ("BCLI") and months of consultation with various stakeholder groups. The Bill largely adopted the recommendations in the Uniform Franchises Act proposed by the Uniform Law Conference of Canada.

The Bill moved very quickly through the legislature, receiving its second reading on October 7, 2015 and its third and final reading on October 20, 2015. It received royal assent on November 17, 2015, and will come into force by regulation of the lieutenant governor in council.

With the enactment of the Franchises Act , British Columbia becomes the sixth province in Canada to introduce franchise legislation, following Alberta (*Franchises Act*, R.S.A. 2000, c. F-23), Manitoba (*The Franchises Act*, C.C.S.M. c. F156), Ontario (*Arthur Wishart Act (Franchise Disclosure), 2000*, S.O. 2000, c. 3 ("AWA")), New Brunswick (*Franchises Act*, S.N.B. 2014, c. 111) and Prince Edward Island (*Franchises Act*, R.S.P.E.I. 1988, c. F-14.1).

The Government is currently in the process of developing draft regulations, which will bring the Franchises Act into force and establish substantive disclosure requirements that franchisors will be required to meet. No formal timeline has been given for the release of the draft regulations, but it is anticipated that they will be introduced sometime in 2017.

The introduction of the Franchises Act will have significant implications for franchisors carrying on business in British Columbia, or who intend to establish franchises in British Columbia in the future. Among other things, franchisors will have new mandatory disclosure obligations to prospective franchisees, franchisees will have statutory rights of rescission and rights of action against a franchisor if the franchisor fails to provide proper disclosure or makes a material misrepresentation to a prospective franchisee, and both parties will have statutory duties of fair dealing which will govern the performance and enforcement of the franchise agreement, as well as the exercise of their respective rights under the franchise agreement. These sorts of obligations, rights

and remedies are all features of the legislation in Alberta, Manitoba, Ontario, New Brunswick and Prince Edward Island as well.

Key Features of the *Franchises Act*

A. Application

When the Franchises Act comes into force, it will apply to all franchises operating wholly or partly in British Columbia, including those for which the franchise agreement was renewed or extended after the Act came into effect (section 2).

Unlike the franchise legislation in certain jurisdictions in the United States (e.g. California), the Franchises Act does not purport to regulate the relationship between franchisors and franchisees, other than by imposing a duty of fair dealing. It also does not provide for any regulatory oversight or administration of the franchise disclosure process. Instead, it provides private rights of action to franchisees in circumstances where franchisors do not comply with their mandatory disclosure obligations. In this regard, franchising in British Columbia will continue to be a largely self-governing industry under the *Franchises Act*.

The Act will prohibit parties to a franchise agreement from contracting out of its application by selecting the laws of another jurisdiction as the governing law of the agreement, or by selecting a forum or venue outside of British Columbia for the litigation or arbitration of disputes relating to the franchise (section 12).

The Act also provides that any attempt by a franchisee or a prospective franchisee to waive or release a right, obligation or requirement conferred or imposed by the Act is void, unless it relates to the settlement of a specific action, claim or dispute (section 13).

B. Disclosure Obligations

The most significant feature of the Franchises Act is that franchisors in British Columbia will be required to provide prospective franchisees with a disclosure document. The disclosure requirements established by the *Franchises Act*, and the limited exceptions to those requirements (which are set out in sections 5(8) through (13)), are substantially similar to those in place in the other regulated provinces. Accordingly, for franchisors that are already carrying on business in those provinces, the burden of the new disclosure regime will likely be relatively minimal.

The disclosure document contemplated under the Franchises Act must summarize all "material facts" regarding the franchise (section 5). The Franchises Act defines a "material fact" as "any information about the business, operations, capital or control of the franchisor or franchisor's associate, or about the franchise or the franchise system, that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted or on the decision to acquire the franchise" (section 1). The disclosure document must also contain certain prescribed financial statements for the franchisor, copies of all proposed franchise agreements and other agreements relating to the franchise to be signed by a prospective franchisee, and certain mandatory statements that have the purpose of assisting a prospective franchisee in making informed investment decisions with respect to the franchise.

Franchisors will be required to provide the disclosure document to prospective franchisees at least 14 days before a franchisee signs the franchise agreement or any other agreement relating to the franchise, or pays any consideration to the franchisor in relation to the franchise. The mandatory 14-day disclosure period is identical to the requirements under the franchise legislation in the other regulated provinces, and is intended to ensure that prospective franchisees have sufficient time to review the disclosure document and seek advice from their legal or accounting advisors before deciding whether to proceed with the franchise opportunity.

The Franchises Act provides that the disclosure document must be delivered as one complete document at one time, and it must be delivered personally, by email or by any other prescribed method. The regulations may establish other prescribed methods for delivery of a disclosure document.

If a franchisor becomes aware of a "material change" after providing a disclosure document to a prospective franchisee, the franchisor will be required to provide the prospective franchisee with a written statement of material change before the franchisee signs the franchise agreement or any other agreement relating to the franchise (section 5(6)). A "material change" is similar to a "material fact", except that a "material change" is restricted to facts that would reasonably be expected to have a "significant adverse effect" on the value or price of the franchise to be granted or on the prospective franchisee's decision to acquire the franchise. The franchisor will be required to provide the statement of material change to the prospective franchisee as soon as practicable after the change occurs.

While the disclosure obligations under the Franchises Act are substantially similar to those in place in the other regulated provinces, there are some important differences. By way of example, unlike the franchise legislation in Ontario, which requires strict compliance with the statutory disclosure regime, the British Columbia *Franchises* Act requires "substantial compliance" by franchisors (which is the applicable standard in Alberta and Manitoba as well). Pursuant to section 9 of the *Franchises Act*, a disclosure document or statement of material change will satisfy the requirements of the Act despite a defect in form, a technical irregularity or an error, provided the defect, irregularity or error does not affect the substance of the disclosure document or statement of material change, and the disclosure document or statement of material change otherwise substantially complies with the *Act*.

C. Remedies for Insufficient, Late or Failed Disclosure

The Franchises Act provides franchisees with statutory rescission rights in circumstances where a franchisor has failed to comply with the disclosure provisions of the *Act*.

Pursuant to section 6(1) of the *Franchises Act*, a franchisee may rescind the franchise agreement within 60 days after receiving a disclosure document if the franchisor failed to provide the disclosure document or a statement of material change within the 14-day timeframe required by section 5, or if the contents of the disclosure document did not meet the requirements of section 5.

If a franchisor fails to provide a disclosure document altogether, section 6(2) provides that the franchisee may rescind the franchise agreement within two years after entering into it.

To exercise one of these rescission rights, a franchisee must deliver a notice of rescission in writing to the franchisor within the timeframe prescribed under the Franchises Act (sections 6(3) and (4)). Upon receipt of the notice of rescission, the franchisor must, within 60 days: (i) refund to the franchisee any money received from the franchisee in relation to the franchise, other than money for inventory, supplies or equipment; (ii) purchase from the franchisee any inventory that the franchisee had purchased under the franchise agreement and remaining as of the effective date of rescission, at a price equal to the purchase price paid by the franchisee; (iii) purchase from the franchisee any supplies or equipment that the franchisee had purchased under the franchise agreement, at a price equal to the purchase price paid by the franchisee; and (iv) compensate the franchisee for any losses the franchisee incurred in acquiring, setting up and operating the franchise, less the amounts described above (section 6(5)). If the franchisor fails to comply with section 6, a franchisee may commence a proceeding against the franchisor in the Supreme Court of British Columbia, seeking, among other things, a declaration of rescission with respect to the franchise agreement.

Collectively, the rescission rights established by the Franchises Act provide powerful remedies to franchisees and strong incentives for franchisors to comply with the disclosure provisions of the *Act*.

D. Remedies for Misrepresentation

The Franchises Act provides remedies for franchisees that have suffered loss due to a misrepresentation in a disclosure document or statement of material change provided by a franchisor, or as a result of a franchisor's failure to comply in any way with the disclosure requirements. Pursuant to section 7(1) of the *Act*, a franchisee has a statutory right of action for damages against a franchisor, the franchisor's broker, the franchisor's associate, and every person who signed the disclosure document or statement of material change, with respect to any such loss. Section 7(2) appears to relieve franchisees from one of the ordinary burdens of proof for a misrepresentation claim by providing that if a disclosure document or statement of material change contains a misrepresentation, a franchisee who acquired a franchise to which the document relates is conclusively deemed to have relied on the misrepresentation. Section 7(3) contains a similar provision for circumstances in which a franchisor fails to provide a statement of material change, as required under section 5(6).

Section 8 sets out various exceptions and defences that a franchisor or a person other than a franchisor can raise in relation to a claim for misrepresentation under section 7(1). Pursuant to section 8(1), a person will not be liable in an action for misrepresentation under section 7(1) if the person can prove that the franchisee acquired the franchise with actual knowledge of the misrepresentation or material change at issue. Under section 8(2), a person other than a franchisor can avoid liability in a claim for misrepresentation if they can prove any one of several defences relating to their knowledge of the misrepresentation or material change or their consent for the document to be provided to the franchisee.

E. Duty of Fair Dealing

Section 3(1) of the Franchises Act imposes on each party to a franchise agreement a duty of fair dealing with respect to the performance and enforcement of the franchise agreement, as well as the exercise of a right under the franchise agreement. Section 3(3) provides that the duty of fair dealing includes the obligation to act in good faith and in accordance with reasonable commercial standards.

Pursuant to section 3(2), if a party to a franchise agreement breaches the duty of fair dealing, the other party will have a right of action for damages against that party in relation to the breach.

The duty of good faith and fair dealing is not a new concept. The common law has recognized that parties to a franchise agreement must deal honestly, fairly and reasonably with each other, with due regard for one another's interests. Further, the duty has been codified, in one form or another, in the franchise legislation in each of Alberta, Manitoba, Ontario, New Brunswick and Prince Edward Island.

While the duty of fair dealing has sometimes been characterized as a duty of "utmost good faith", recent case authorities have determined that what is required is that the parties act with simple good faith and in accordance with reasonable commercial standards: *Ma v. Nutriview Systems Inc.*, 2014 BCSC 725, rev'd on other grounds 2016 BCCA 4; *TDL Group Ltd. v. Zabco Holdings Inc. et al.*, 2008 MBQB 239; *Ismail v. Treats Inc.*, 2004 NSSC 16. It is well settled that franchisors do not owe a fiduciary duty to their franchisees: *Jirna v. Mister Donut of Canada*, [1975] 1 S.C.R. 2; *Shelanu Inc. v. Print* Three Franchising Corp. (2000), 11 B.L.R. (3d) 69 (Ont. S.C.J.), rev'd in part (2003), 64 O.R. (3d) 533 (Ont. C.A.), additional reasons (2006) 19 B.L.R. (4th) 19 (Ont. C.A.); Machias v. Mr. Submarine Ltd. (2002), 24 B.L.R. (3d) 228 (Ont. S.C.J.).

What the duty of fair dealing requires in a given case depends on the specific terms of the franchise agreement in question and the circumstances of the case. Courts have confirmed that the duty is context-specific, and no bright line rule can be established for universal application to all cases: *Fairview Donut Inc. v. The TDL Group Corp*., 2012 ONSC 1252, aff'd 2012 ONCA 867; *Trillium Motor World Ltd. v. General Motors of Canada Ltd.*, 2015 ONSC 3824. Courts have also confirmed that the duty of fair dealing relates to the performance and enforcement of the franchise agreement; it does not create rights or obligations separate from the franchise agreement, and it cannot be used to replace, interfere with or avoid the contract that the parties have made: *Fairview* Donut, supra at para. 500.

F. Franchisees' Right to Associate

Section 4 of the Franchises Act provides that a franchisee may associate with other franchisees and may form or join an organization of franchisees, and franchisors are prohibited from interfering with franchisees' right to associate, or penalizing or threatening to penalize franchisees for exercising their right of association.

Section 4 also provides that any provision in a franchise agreement that purports to interfere with, prohibit or restrict a franchisee's ability to exercise its right of association is void, and that if a franchisor or a franchisor's associate contravenes the provisions of section 4, the franchisee will have a right of action for damages against the franchisor or the franchisor's associate, as the case may be.

Regulations under the *Franchises Act*

Most of the substantive disclosure requirements under the Franchises Act will be set out in the regulations that are currently being developed by the government. The regulations will likely address, among other things, certain categories of material facts that franchisors must disclose in their disclosure documents, the risk warnings that must be provided to prospective franchisees, the review level of the financial statements that must be included in the disclosure document, and the use of disclosure documents that were prepared under the disclosure laws of another jurisdiction.

The regulations are expected to be based on the Uniform Law Conference Disclosure Document Regulation and the recommendations provided by the BCLI in its Report on a Franchise Act for British Columbia, both of which contemplate many of the same disclosure requirements that the other regulated provinces have included in their regulations. Accordingly, it is unlikely that there will be any surprises when the regulations are finally introduced.

Key Takeaways

When the Franchises Act comes into force, it will significantly change the law regarding franchising in British Columbia. Among other things, franchisors in British Columbia will have mandatory disclosure obligations, which those who are not already doing business in a disclosure jurisdiction will not be accustomed to. Franchisors who are currently operating in British Columbia or are planning to expand their networks here should consult with experienced franchise counsel to ensure that they are up to speed with the requirements of the new legislation by the time it comes into force.

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By

Blair Rebane, Matthew G. Swanson, Eric C. Little

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BLG Offices

Calgary

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

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749