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# Franchising in Ontario

## An Overview for prospective franchisors and franchisees

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# Introductory Remarks

- **Introduction**
- **Explosive growth in last 25 years**
- **Franchises are a growing global phenomenon**
- **Big Macs in Red Square**
- **Holiday Inns in Buenos Aires**
- **Franchises are associated with safety, comfort and community**
- **Recognition is their appeal.**

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# Summary of Presentation

1. What is a “franchise”?
2. Why is a franchise different?
3. Legal considerations when purchasing a franchise
4. Rights/obligations of the franchisee and franchisor
5. Effective use of legal counsel in setting up a franchise

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# 1. Definition of “Franchise”

**A franchise exists where:**

- a) The franchisor grants the franchisee a right to engage in a business;**
- b) The franchisee is required to make one or more payments, whether direct or indirect to the franchisor;**

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- 1. Definition of “Franchise”**
  - c) The goods or services sold by the franchisee are substantially associated with the franchisor’s trade-mark; and**
  - d) The franchisor exercises significant control over, or offers significant assistance in the franchisee’s method of operation.**



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# 1. Definition of “Franchise”

## Examples:

- a) Bottler and reseller of *Coca-Cola* using Trade-Mark?
- b) Fast food restaurant where methods of operation and décor are dictated?
  - Distributor of brand-name product where some marketing assistance is given?



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## **2. Why is a franchise different from a traditional business?**

- **Franchisee is purchasing a business opportunity which includes express or implied claims about the prospects of success**
- **The desire is to broker the franchise's reputation and system into profits that would not be otherwise achievable in a traditional equivalent**

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## 2. Why is a franchise different from a traditional business?

- Franchisee must often give up control of location, procedures, accounting, marketing and “look”
- May have sales quotas to achieve
- May be required to devote full time to business
- May be required to use franchisor’s suppliers
- Royalties \$\$\$\$

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### 3. Legal Considerations

- *Arthur Wishart Act (Franchise Disclosure), 2000*
- “Wishart Act” is franchisee friendly legislation that imposes upon franchisor a duty to make pre-sale disclosure of material facts to franchisee
- Act also imposes a duty of good faith and fair dealing



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## 3. Legal Considerations

### Disclosure Obligations:

- 14 days before any payment or the signing of any document franchisor must provide disclosure document in form prescribed

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## 3. Legal Considerations

### Disclosure Obligations (Contents):

- document must contain all “material facts” including those prescribed
- Financial statements as prescribed
- Copies of franchise agreements and all other agreements relating to the franchised business (sublease, ops manual etc.)
- Prescribed statements
- Such other documents/info prescribed

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## 3. Legal Considerations

### Disclosure Obligations (Contents):

- “material facts” include all facts that would or could significantly influence value of purchased franchise
- Alberta legislation: info that could reasonably be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise

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## 3. Legal Considerations

### Disclosure Obligations (Contents):

- **Business background of franchisor and principals**
- **convictions against franchisor or principals for fraud or deceptive business practices or violations of laws regulating a franchise or business**
- **Administrative orders or penalties under laws regulating a franchise or business**
- **Liability for civil misrepresentation, unfair or deceptive business practices or laws that regulate a franchise or business**

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## 3. Legal Considerations

### Disclosure Obligations (Contents):

- Bankruptcy or insolvency proceedings in the last 6 years
- Financial statements for most recent fiscal year
- List of costs for establishment of franchise
- Estimates of annual operating costs and earnings projections can be provided

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## 3. Legal Considerations

### Disclosure Obligations (Contents):

- Description of financing arrangements
- Training
- Advertising fund contributions
- Restrictions or requirements respecting suppliers or clients
- Policies respecting volume rebates
- Rights to trade-marks

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## 3. Legal Considerations

### Disclosure Obligations (Contents):

- Licences, permits etc. needed to operate the franchise
- Requirement for personal participation
- Encroachment policy
- Details of franchise terminations
- List of all franchises in Ontario
- Certificate as to disclosure

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## 3. Legal Considerations

### Disclosure Obligations (Exemptions):

- Sale by one franchisee to another
- Insiders (officer/director for 6 mos.)
- Additional franchises
- Executors, trustees, receiver, sherriff
- Fractional exemption (sales <20%)
- Renewals
- Very small arrangements (<\$5000, <1yr)
- Sophisticated franchisee (>\$5MM/year)

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## 3. Legal Considerations

### Disclosure Obligations (Remedies):

- Failure to provide disclosure document gives franchisee right to rescind agreement 2 yrs from signature
- Defect in disclosure gives franchisee right to rescind within 60 days of receiving document

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## 3. Legal Considerations

### Disclosure Obligations (Remedies):

The franchisor has within 60 days of the date of rescission

- to refund money received other than money for inventory supplies or equipment
- To purchase from the franchisee inventory, supplies and equipment purchased under the Agreement
- Compensate for losses incurred in acquiring, setting up and operating the franchise

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## 3. Legal Considerations

### Duty of Good Faith and Fair Dealing:

- Franchisor has a duty to act in “good faith” in accordance with reasonable commercial standards in the performance and enforcement of the franchise agreement
- Commercial standard of decent conduct

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## 3. Legal Considerations

### Other:

- Form of franchise agreement
- lease issues
- Tax and structuring
- Employment law
- Insolvency and bankruptcy
- Dispute resolution and litigation

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## 4. Rights/Obligations of Parties

- These will be governed by the Franchise Agreement
- They are usually disclosed in the disclosure document
- Grant of business using a “system”
- “System” is set out in operating/procedures manual
- Deviation from “system” is usually a default under the franchise agreement

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## 4. Rights/Obligations of Parties

### Franchisee:

- Territory of franchisee is often defined
- Rights over trade-marks are specifically stated
- Franchisee is obligated to pay royalties, advertising fees and other amounts as required
- Training usually required



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## 4. Rights/Obligations of Parties

### Franchisee:

- Payment into ad fund and periodic local advertising (eg. Yellow pages)
- Obligations to purchase and maintain certain equipment and minimum inventory
- Obligation to update “look” as and when determined by franchisor at franchisee’s cost

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## 4. Rights/Obligations of Parties

### Franchisee:

- Requirement to keep books open for audit/inspection
- Non-compete/solicit upon termination
- Restrictions on assignment



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## 4. Rights/Obligations of Parties

### Franchisor:

- **Disclosure and good faith obligations**
- **Other obligations are contractual**
- **Location assistance and site planning**
- **Location design**
- **Equipment sourcing and financing**

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## 4. Rights/Obligations of Parties

### Franchisor:

- Opening assistance and supervision
- Training
- Accounting forms, software etc.
- Promotional material, manuals, etc.
- Continuing assistance

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## 5. Legal Counsel

- Franchisee should ideally have advisors selected before actively seeking a franchise
- Legal and financial advisors should be involved at disclosure stage
- Legal advisor will review disclosure to ensure that it is complete and given at appropriate times

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## 5. Legal Counsel

- At that point, advisors can review all documents including the franchise agreement, sublease, personal guarantee, general security agreement
- Financial advisors will review financial statements to assist franchisee in assessing risks and costs

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## 5. Legal Counsel

### Other issues:

- Incorporation
- taxation and structuring advice
- regulatory issues (eg. Day Nurseries Act)
- licensing (City, liquor)
- employment issues
- commercial lease matters

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# Conclusion

- **Important for parties to know their rights since enactment of Wishart Act**
- **Effective use of legal and financial advisors can greatly assist parties in properly evaluating franchise opportunities**
- **Questions?**

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# Thank you.

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