UPDATED RECOMMENDATIONS TO AMEND THE *ARTHUR WISHART ACT (FRANCHISE DISCLOSURE)*, *2000*

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Submitted to: Business Law Advisory Council

Submitted by: The Ontario Bar Association, Franchise Law Section

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Introduction

The Ontario Bar Association (the "OBA") appreciates the opportunity to comment on the potential amendments to the Arthur Wishart Act (Franchise Disclosure), 2000 (the "*Wishart Act*") that the Ontario Business Law Advisory Council ("BLAC") is considering.

The OBA

Established in 1907, the OBA is the largest voluntary legal association in Ontario and represents some 16,000 lawyers, judges, law professors and law students. The OBA is pleased to analyze and assist government with dozens of legislative and policy initiatives each year - both in the interest of the profession and in the interest of the public.

This submission has been primarily developed by the OBA Franchise Law Section, which includes the leading experts in franchise law issues, including many whose legal practices are devoted to representing franchisors, franchisees, or both. Members of the OBA Franchise Law Section include both solicitors who advise franchise companies on starting or expanding franchise systems, deal with the franchise contracts, and compliance with the *Wishart Act*; and barristers who deal with disputes that arise under the *Wishart Act*, including litigation. The Franchise Law Section also has a number of lawyers who practice in-house with franchisor companies.

Overview

As discussed in the second round of potential amendments introduced in May 2017 (the "May Recommendations"), a significant number of the potential amendments introduced in the May Recommendations and earlier Fall 2015 recommendations (the "Fall Recommendations") were based on OBA recommendations from its January 2015 submission (the "2015 OBA Submissions").[1]

The OBA's submissions consist of the following:

A) Comments on the Fall Recommendations;
B) Comments on the May Recommendations;
C) A discussion of the 2015 OBA Submissions that have not yet been adopted by the BLAC; and
D) Further recommendations for changes to the *Wishart Act*.

[1] Recommendations to Amend the Arthur Wishart Act (Franchise Disclosure), 2000, January 9, 2015, online: https://www.oba.org/submissions?keywords=wishart

Part A – Commentary on the Fall Recommendations

The proposed amendments to the *Wishart Act* as set out in the Fall Recommendations largely reflect the recommendations in the 2015 OBA Submissions. For organizational purposes, we have outlined the genesis of the amendments below.

1. Remove the term "service mark" from the definition of "franchise" under section 1(1)(a)(i) (Item 8(a) of the Fall Recommendations)

The OBA is supportive of this recommendation, addressed at Note 1 of the 2015 OBA Submissions.

2. Allow for the fact that the franchisor may, itself, be a licensee of the marks. (Item 8(a) of the Fall Recommendations)

The OBA is supportive of this recommendation, addressed at Note 1 of the 2015 OBA Submissions.

3. Ensure that franchisors who have the right to exert significant control over, or to provide significant assistance in, the franchisee's method of operation are not exempted from the AWA merely by failing to exercise that right. (Item 8(b) of the Fall Recommendations)

The OBA is supportive of this recommendation, addressed at Note 2 of the 2015 OBA Submissions.

4. Clarify that only the agreement by which the franchise is actually granted (and not merely a deposit, confidentiality or other ancillary agreement) triggers a disclosure obligation on the part of the franchisor (and a potential rescission remedy for the benefit of the franchisee). (Item 8(c) of the Fall Recommendations)

The OBA is supportive of this recommendation, addressed at Note 4 of the 2015 OBA Submissions.

5. The exemption from the AWA in the case of a licence granted by a licensor to a single licensee should be clarified to state that the relevant geographic scope of the license be Canada (section 2(3)(5)). (Item 9 of the Fall Recommendations)

The OBA is supportive of this recommendation, addressed at Note 10 of the 2015 OBA Submissions.

6. U.S. GAAP and GAAS, as well as IFRS and IAASB auditing and review engagement standards as adopted by other countries, should be deemed to be acceptable bases for the preparation and auditing or review of financial statements required to be attached to a disclosure document delivered under Section 5(4) of the AWA. (Item 10 of the Fall Recommendations)

The OBA is supportive of this recommendation, addressed at Note 14 of the 2015 OBA Submissions.

7. A Form – Certificate of Franchisor should be added, applicable to the Statement of Material Change required to be delivered under Section 5(5) of the AWA. (Item 11 of the Fall Recommendations)

The OBA is supportive of this recommendation, addressed at Note 16 of the 2015 OBA Submissions.

8. Clarify that the former director/officer exemption ceases to be available on the expiry of a fixed period after the prospective franchisee has ceased to be an officer or director of the franchisor; and confirm that the exemption should also apply where the prospective franchisee is a corporation owned by such an individual. (Item 12 of the Fall Recommendations)

The OBA is supportive of this recommendation, addressed at Note 17 of the 2015 OBA Submissions.

9. The fractional franchise disclosure exemption should be amended to clarify that the time period for measuring anticipated percentage of sales for the purposes of the exemption is the franchise's first year of operation. (Item 13 of the Fall Recommendations)

The OBA is supportive of this recommendation, addressed at Note 17 of the 2015 OBA Submissions.

10. The De Minimis Investment Disclosure Exemption's concept of "total annual investment" be replaced with the concept of an "initial investment" anticipated by the parties at the time of entry into the franchise agreement to clarify the timing and method of calculating the relevant investment amount for the purposes of the exemption. (Item 14 of the Fall Recommendations)

The OBA is supportive of this recommendation, addressed at Note 17 of the 2015 OBA Submissions.

However, the Section recommends that the BLAC carefully consider that determining the "initial investment" can be difficult and may have to take into account funds spent over an express period of time surrounding the opening.

11. The Large Investment Disclosure Exemption should be amended to improve consistency between the Large Investment Disclosure exemption and the De Minimis Investment Exemption. (Item 15 of Fall Recommendations)

The OBA is supportive of this recommendation, addressed at Note 17 of the 2015 OBA Submissions.

However, the OBA recommends that the BLAC carefully consider that determining the "initial investment" can be difficult and may have to take into account funds spent over an express period of time surrounding the opening.

Part B – Proposed Amendments to the Act

As with the Fall Recommendations, the proposed amendments to the *Wishart Act* as set out in the May Recommendations largely reflect the recommendations in the 2015 OBA Submissions. For organizational purposes, we have outlined the genesis of the amendments below. We have added additional commentary where required.

1. Amending the Wishart Act regulation to provide an exhaustive/finite list of "material facts" for the purposes of disclosure in the FDD, while including U.S.-style "anti-fraud" requirements.

The OBA is generally supportive of changes to the *Wishart Act* that take out uncertainty in respect of what is required to be disclosed under section 5(4) of the legislation. This was addressed at Note 7 of the previous 2015 OBA Submissions.

2. Revise the definition of "material change" in section 1(1) of the Wishart Act to correspond to the changes proposed in #1.

See the response to #1.

3. Deem substantial compliance to be acceptable.

The OBA is supportive of this recommendation, which corresponds to Note 13 of the 2015 OBA Submissions.

The OBA suggests that the BLAC consider providing a precise meaning under the legislation for "substantial compliance."

4. Allow wrap-around disclosure.

The OBA is supportive of this recommendation.

5. Allow the parent company's financials to be disclosed if the parent guarantees the sub.

The OBA Franchise Section is supportive of this recommendation, but would note that care should be taken to ensure that it is applied appropriately to corporate structures that have more complexity than a single parent and sub (e.g. multiple parents and subsidiaries).

6. Revise the definition of "franchise" to make clear that the purchase of a reasonable amount of inventory or services at wholesale prices does not satisfy the payment element of the definition.

The OBA is supportive of this recommendation.

7. Clarify that the AWA only applies to Ontario franchises (the "Midas" issue).

The OBA is supportive of this recommendation, which corresponds to Note 9 of the 2015 OBA Submissions.

8. Amend section 6(6) to net out profits, require the delivery of inventory, supplies and equipment clear of liens and encumbrances, and impose obligations related to confidentiality, proprietary materials, and the preservation of assets.

This partially corresponds to Note 19 of the previous 2015 OBA Submissions, however, the Section notes that the BLAC is likely to find differing views on this subject as between franchisee and franchisors.

For instance, franchisee-side counsel in the Section expressed concern that the requirement to deliver inventory, supplies and equipment clear of liens and encumbrances would be difficult without a corresponding obligation on the franchisor to pay the amounts owed under the rescission notice, noting the potential difficulty of the franchisee paying these amounts. Alternatively, franchisee-side counsel suggested that franchisors could have the option of paying the lienholder/encumbrancer directly and obtaining credit for it in respect of the rescission compensation claim. In addition, franchisee-side counsel expressed concern regarding the confidentiality and preservation requirements.

Others suggested that an Alberta-style of damages calculation in respect of rescission, namely the "net losses" purportedly suffered by the franchisee, may be a more efficient

way to proceed in respect of rescission claims and would remove some of the practical and financial complexities of the current process under section 6(6).

9. Qualify section 11 to indicate that it does not apply to waivers and releases given in accordance with settlement (the "Tutor Time" exception)

The OBA is supportive of this recommendation as a codification of the current common law.

Part C – The 2015 OBA Submissions That Have Not Yet Been Adopted by the BLAC

From our review, we understand that several of the recommendations made by the OBA in its 2015 Submissions have not been adopted by the BLAC. In respect of these remaining recommendations, the OBA has the following comments on certain of these recommendations:

1. Note 1 (pages 11-13) – Section 1(1)(a)(i) – Definition of "franchise" – the proposed deletion of "or advertising".

The OBA still supports this recommendation.

2. Note 3 (pages 14-16) – Sections 1(1)(b)(i) and (ii) – Definition of "franchisee" – the proposed amendments regarding "location assistance".

The OBA still supports this recommendation.

3. Note 6 (page 19) – Section 1(1) – Definition of "franchisor's affiliate".

The OBA still supports this recommendation.

5. Note 8 (pages 20-21) – section 1(1) – Definition of "prospective franchisee".

The OBA still supports this recommendation.

8. Note 18 (pages 36-37) – sections 6(1) and (2) – Rescission for Both Late and No Disclosure.

The OBA still supports this recommendation.

10. Note 20 (pages 39-40) – section 7(5) – Defences Against An Action for Misrepresentation where Damages Sought (Other than Against Franchisor).

The OBA still supports this recommendation.

11. Note 21 (pages 40-41) – section 10 – Restriction of the Application of the Laws of Ontario or Restriction of the Jurisdiction or Venue to a Forum Outside Ontario

The OBA still supports this recommendation.

Part D – Further Recommendations for Changes to the Wishart Act

After internal consultation of OBA members, the following is an outline of recommended changes to the *Wishart Act* that have not been addressed in the 2015 Submissions. The recommendations are organized by statutory section.

Section 2(3)(5):

We note that this section is addressed at Item 9 of the Fall Recommendations.

In addition, the broad language of this exemption may actually encompass single license Canadian master franchisees. In other words, if a master franchise arrangement contained an arrangement such as the one outlined in section 2(3)(5) but it also provided further rights beyond the license, it arguably could still qualify for this exemption. This is likely not the intent of the legislation.

For reference purposes, the current language is: "*An arrangement arising from an agreement between a licensor and a single licensee to license a specific trade-mark, service mark, trade name, logo or advertising or other commercial symbol where such licence is the only one of its general nature and type to be granted by the licensor with respect to that trade-mark, service mark, trade name, logo or advertising or other commercial symbol*."

Sections 4(4), 10, and 11:

To the extent that a franchise agreement provision is void under these sections due to conflict with the *Wishart Act*, it should only be void to the extent of the conflict or inconsistency.

Section 5(7)(a):

There is a general, policy-based concern that a franchisor may be liable for significant rescission damages under section 6(6) if it is not able to rely on the section 5(7)(a) exemption for a franchisee's sale of its franchise despite the fact that the franchisor did not (a) instigate the sale process, or (b) receive the financial benefit of the sale. The rescission damages in the case of this scenario are disproportionate to the alleged

wrongdoing, and it is questioned whether this was the legislative intent in respect of this provision.

There is also a concern that the assignment of a franchise is not covered by the definition of a grant of a franchise for the purposes of this exemption.

In addition, the Section advises that there are opposing views regarding whether the exemption for a sale not by or through a franchisor should permit activities by the franchisor that are required as part of the consent process identified in the franchise agreement, including whether this ought to include the execution of a new form of franchise agreement, and whether the possible conduct that could be considered consent requirements may be overbroad.

Section 5(7)(e):

The fractional franchise disclosure exemption is addressed at Item 13 of the Fall Recommendations. However, it is unclear how the anticipated percentage should be documented. A possible solution is a joint declaration at the commencement of the franchise relationship that the parties agree that this exemption will apply. This would have to comply with section 11 of the *Wishart Act*.

Sections 5(7)(h):

As per section 5(7)(e), there should not be a retrospective examination of whether the prescribed amount has been met or not. The expression "is investing" is vague and provides uncertainty in respect of the application of the exemption. If there is no disclosure document, there may not be evidence available to determine that the franchisee "is investing" the prescribed amount.

Section 5(8):

A grant should not be considered to be effected by or through a franchisor if training is provided to the franchisee by the franchisor. Similarly, meetings between the franchisor and franchisee and the collection of financial information should not trigger the disclosure obligation.

Section 6(1):

There is an issue as to whether the 60 days should run from the execution of the franchise agreement rather than the receipt of the disclosure document in order to provide consistency with section 6(2). Further, if the franchise agreement is executed over 60 days after receipt of the disclosure document, there is arguably nothing to rescind within that 60 day period.

Sections 6(1) and 6(2):

The sections refer to a right to rescind "the franchise agreement." It should be clarified whether this is intended to include the actual agreement granting the franchise, or whether it includes ancillary agreements. Furthermore, there may be a need for documents such as non-disclosure agreements and other documents executed during the course of the franchise relationship to survive any rescission.

See also Note 18 of the 2015 OBA Submissions.

Section 6(3):

The legislation does not require an address for service, yet the notice of rescission has to be sent to this address. Similarly, there is no requirement for a fax number under the legislation.

Section 6(6):

Given the broad definition of "franchisor's associate" in the *Wishart Act*, it may include employees of the franchisor. As such, liability for rescission under section 6(6) of the *Wishart Act* may apply to franchisor employees, who are unlikely to have received any personal material benefit from the franchise arrangement. For the purposes of rescission claims under section 6(6), true employees should be excluded.

Section 6(6):

Under this section, a franchisor's associate may be liable for damages from a rescission claim even if that franchisor's associate was not necessarily involved in the disclosure process itself. The definition of "franchisor's associate" under the *Wishart Act* does not specifically require involvement in the disclosure process. There is an inherent unfairness of this scenario that should be addressed.

Section 6(6):

The OBA notes that changes to section 6(6) are contemplated in the May Recommendations.

It should be examined whether, in order to simplify the calculation of damages in respect of a rescission claim, the rescission damages under the *Wishart Act* should reflect the Alberta Franchises Act model, namely: "compensate the franchisee for any net losses that the franchisee has incurred in acquiring, setting up and operating the franchised business."

Further, there is legislative ambiguity in respect of section 6(6)(a) as to what constitutes "money received from or on behalf of the franchisee, other than money for inventory, supplies or equipment." Is this intended to include any rent paid under a sublease with the franchisor, particularly if the payment was passed through to the lessor landlord? If the sublease was made between the franchisee and a company that is related to the franchisor and rent is paid directly to the landlord, does that qualify under section 6(6)(a)? If the intention of the legislation is *de facto* disgorgement, there is a concern that franchisors are obligated under section 6(6) to "disgorge" more than they actually received.

The issue of how to treat perishable inventory in light of the sixty-day rescission period should be addressed.

Section 6(6)(d):

Where the franchisee is a corporation, losses for the purposes of this provision should not include losses incurred by an individual operator or owner of the franchisee. This includes purported lost income and/or notional deferred management wages.

Limitation Period:

The precise limitation period for bringing actions under the legislation should be set out (in accordance with the Ontario Court of Appeal's *Philthy McNasty's* decision).

Conclusion

The OBA appreciates the opportunity to provide its input to the BLAC, and hopes that these recommendations with assist the Committee in its work amending Ontario's franchise legislation. To the extent that the BLAC is considering substantive amendments to the *Wishart Act*'s regulations, the OBA Franchise Section would be pleased to provide further input in this regard.