

# FRANCHISING IN CANADA

What Every U.S. Franchisor Needs to Know

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### **Introduction to Canadian Franchising**

#### **THE MARKET**

Canada is made up of 10 provinces and three territories. Its culturally and ethnically diverse population of over 37 million is a tremendous consumer of branded products and services sold by homegrown and imported franchise systems. Many new investor immigrants to Canada make their initial investment in a franchised business.

#### **THE FRANCHISING INDUSTRY**

Approximately 1,200 brands and more than 76,000 franchise units operate across a variety of sectors in Canada. Franchised businesses employed 1.9 million Canadians directly or indirectly in 2019, and the franchise sector, not including auto dealerships and grocers, is estimated to grow and increase its total GDP contribution to \$100.6 billion.

#### **FRANCHISING SECTORS IN CANADA**

With the exception of banking, franchising is prevalent in every major retail sector in Canada. Well-known global brands dominate in automotive sales and services, hotels and resorts, real estate brokerages, gasoline sales, tax services, home services, restaurants of every service type, fashion, professional services, telecommunications, supermarkets and pharmacies.

#### **FRANCHISE LEGISLATION IN CANADA**

Alberta, Ontario, New Brunswick, Prince Edward Island, Manitoba, and British Columbia have provincial franchise legislation. None of these provinces, however, requires registration to establish a franchise, and franchisors looking to sell franchises in Canada do not need to deal with any franchise-specific regulatory authority at a provincial or federal level.

## A REGIONAL PERSPECTIVE

### A Regional Perspective

#### ONE COUNTRY, FIVE MARKETS

While Canada is often treated by franchisors as one international market, U.S.-based franchisors will do best by analyzing the country as one that represents five regional markets, with 10 provinces that might be viewed as 51st to 60th states.

### Demographic, Regional and Legislative Summary

REGION	Western	Prairies	Central	Quebec	Maritimes
PROVINCES	British Columbia	Manitoba, Saskatchewan, Alberta	Ontario	Quebec	Newfoundland, Prince Edward Island, New Brunswick, Nova Scotia
FRANCHISE LEGISLATION	Yes	Manitoba and Alberta only	Yes	Civil Code	Prince Edward Island and New Brunswick only
PRINCIPAL CITIES AND POPULATION	Vancouver 2,300,000 Victoria 80,000	Winnipeg 730,000 Regina 210,000 Saskatoon 260,000 Edmonton 1,000,000 Calgary 1,200,000	Greater Toronto Area 6,000,000 Southern Ontario 12,000,000 Ottawa-Gatineau 1,200,000	Greater Montreal Area 4,000,000 Quebec City 760,000	Halifax 400,000 Saint John 120,000 St. John's 200,000 Moncton 140,000 Charlottetown 35,000

## A REGIONAL PERSPECTIVE

### STRONG TIES TO U.S. MARKETS AND CULTURE

American culture is an indelible part of the fabric of Canadian culture, in large part because 75% of Canada's population lives within 100 miles of the U.S. border and virtually all Canadians can access American online media and television. Canada is part of the general distribution network of American-made films. The Toronto International Film Festival, held every September, is a launching pad for many American-made movies.

### LOW COMPETITIVE RISK FROM CANADIAN BRANDS

U.S. franchisors interested in entering the Canadian market need not be significantly concerned about competition from strong Canadian brands. In every market where there is a major Canadian player (Tim Hortons, Shoppers Drug Mart, Canadian Tire or Pizza Pizza) there are other successful international competitors (Starbucks, Pharma Plus, Walmart, Little Caesars) whose franchising principles have translated well to the Canadian market.

### SMALL COMMUNITIES STILL A CHALLENGE FOR U.S. BRANDS

There are relatively few communities in Canada with populations in the 30,000 to 100,000 range. Various American brands have prospered in these communities but find that Canadian demographics do not support their fundamentals.

### CULTURAL CONSIDERATIONS

U.S. franchising companies can view the majority of English-speaking Canadians as markets no different than the nearby regional populations in the U.S. Quebec, however, is a separate cultural demographic. Any brand looking to enter Quebec should consult with local experts to determine if program modifications are advisable.

### CANADIAN FRANCHISE ASSOCIATION

The Canadian Franchise Association is a national, not-for-profit association with more than 700 corporate members representing more than 40,000 business owners, or almost half of the franchise systems operating in Canada. Like the International Franchise Association, but on a smaller scale, the Canadian Franchise Association acts as the voice of franchise businesses in the country and provides members with services and programs such as advocacy, education and training, industry information and best practices.

### National/Provincial Considerations

	National Considerations	And	Or	Provincial Considerations
TRADEMARK	●			
INCORPORATION	●		●	●
UNIT FRANCHISE SALES				●
MASTER FRANCHISING	●		●	●
AREA FRANCHISING				●
REAL ESTATE				●
ADVERTISING	●	●		●
PROFESSIONAL ADVICE	●		●	●
CULTURAL MODIFICATIONS				●

#### PROFILE OF THE AVERAGE CANADIAN UNIT FRANCHISEE TARGET

What does the average prospective franchisee in Canada look like? According to data gathered by the Canadian Franchise Association:

70% are male

35 to 54 years of age

57% live in Ontario

81% are looking to invest in the next year

Has \$50,000 to \$300,000 to invest

Has post-secondary school education

Spends one to two hours per week researching opportunities

Considers brand recognition as the most important criterion in evaluating opportunities

Principal motivation: To be "My own boss"

### CULTURAL CONSIDERATIONS

#### Adapting your franchise to Canada: Matters to consider

American brands must do their due diligence in the following areas before leaping across the border:

##### METRIC SYSTEM

Canada moved from the imperial to the metric system in 1970 and uses this system for everything except Canadian football fields.

##### LANGUAGE LABELLING

Canada has two official languages: English and French. Although French is not used much outside Quebec, Ottawa and parts of New Brunswick, all consumer products (but not signage) must bear French labelling. In Quebec, protective language laws require all signage to be predominately in French. Manuals for use in Quebec must also be translated into French. Franchisors should note spelling nuances when finalizing all written materials.

## CULTURAL CONSIDERATIONS

### CURRENCY

The American dollar, while not legal tender, is widely accepted at most Canadian businesses, usually with an exchange rate that is somewhat less favourable than what is available at financial institutions. Canada has a very strong banking sector which resulted in the most recent recession being a far less dramatic recessionary period than experienced in the U.S. The Canadian dollar took a predictable downturn with the collapse of the oil and gas sector and recently has fluctuated around US\$0.75.

### MENU LABELLING

Effective January 1, 2017, Ontario was the first province to have laws requiring nutritional disclosure on restaurant menus and displays. This applies to systems of at least 20 units.

### CANADIAN ANTI-SPAM LEGISLATION (CASL)

In 2014, Canada introduced important anti-spam legislation which can impact the ability of a franchisor to market to consumers online. This follows previous rules around faxing and telemarketing. U.S. franchisors must take CASL and other marketing-related rules into account when designing their systems for Canada, and may need to modify their practices.

### TAXATION

American franchisors need to consider Canadian withholding tax requirements which affect income-related payments made by Canadian residents to the U.S. entity receiving the payment. This can affect structuring and accounting considerations.

Businesses operating in Canada must make periodic remittances to governmental authorities. These include "Harmonized Sales Tax" collected on sales, employee income tax withholding deductions ("source deductions") and health tax in respect of employees. The amounts of these remittances are typically higher than the amounts remitted by businesses in the US. Franchisors receiving royalties (or receiving revenues from direct sales) in Canada and who have employees in Canada are responsible for making these remittances in respect of their operations as are franchisees in respect of their businesses.

## CULTURAL CONSIDERATIONS

### EMPLOYMENT LAWS

Canadian federal and provincial laws do not provide for at-will employment. Although unionization is commonplace in Canadian manufacturing, it is far less pervasive in the retail sector, where only a handful of employers such as Walmart have unionized workforces. Employees are well protected by human rights and employment standards legislation and are entitled to reasonable notice of termination or compensation in lieu of notice.

### EMPLOYEE COMPENSATION

Minimum wage affecting franchisors is regulated provincially. Current hourly minimum wages range from \$10.25 in Newfoundland to \$15.00 in Alberta. Canada has a tipping culture with a customary tip of 15% paid to servers.

### EMPLOYEE VACATIONS AND DAYS OFF

Employees receive a minimum two weeks vacation entitlement. That can increase to five to six weeks based on length of service, in addition to employer-sponsored “sick days” or “personal days.”

### VICARIOUS LIABILITY AS JOINT EMPLOYER

The topic of vicarious liability is almost as hot north of the border as south. Franchise lawyers, along with the Canadian franchise industry, are keeping a close watch on developments south of the border as they could influence developments in Canada.

### HEALTH COVERAGE

Universal public health care is a bastion of the Canadian landscape. Employers pay an employer health tax based on payroll, which contributes to the cost of basic health care. Despite universal health care, employees do gravitate to employers that offer excellent private group benefit plans for services not covered under the public plan, including dental, eye care, massage, chiropractic therapies and other health services.

## CULTURAL CONSIDERATIONS

### LITIGATION PROCESSES

Canadians are perceived as less litigious than Americans. We have very few jury trials. The timing to complete actions can be lengthier in courts where case management does not exist. Compensation awards, for general damages for pain and suffering, have been capped by the Supreme Court of Canada. The litigation processes are easily understood by those familiar with the American judicial system. Apart from the overwhelming restriction of jury trials to personal injury cases, the primary difference is in the discovery stage. Broad rights of interrogatories do not exist. At first instance, only the party is subject to oral discovery rights and constraints on the length of oral examinations can apply even to the exercise of these rights.

### CLASS ACTION SUITS

Class actions are a constant feature of franchising in Canada. Certification tests are seen to be tailor-made to franchising disputes and this has been recognized by the courts. Many of the important developments in franchising law have arisen from decisions in class proceedings.

### MEDIATION AND ARBITRATION

Canada is a healthy jurisdiction for mediation and arbitration. Some courts have mandatory mediation requirements as a pre-condition to trial. The same considerations which go into whether a franchisor wants to include arbitration requirements in its franchise agreements in the U.S. apply when creating its Canadian paperwork. Since the introduction of franchise legislation, many more judges and arbitrators have become familiar with franchising as a specialized area of the law with a developed understanding of the unique nature of the franchisor-franchisee relationship. For provinces with franchise legislation, litigation and arbitration of statutory claims must take place in the province where the franchise is located.

### Legal Considerations for American Franchisors

#### SIMILAR SYSTEMS, WITH SIGNIFICANT DIFFERENCES, ACROSS U.S.-CANADA BORDER

U.S. and Canadian legal systems, both based on the British system of common law and statute law (except Quebec which uses the civil law system), are similar. Legal concepts are quite interchangeable where they differ in name. Knowledgeable Canadian franchise lawyers have no difficulty discussing and accommodating American legal concepts. Franchise laws should not drive the decision on whether and where to enter the Canadian market. It is important, nevertheless, to understand the significant differences. Franchising laws are a matter of provincial jurisdiction. Other laws which can affect franchising, such as trademark registration and competition law, are under federal jurisdiction.

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#### WHAT YOU NEED TO KNOW ABOUT DISCLOSURE

Disclosure is the key element of Canadian franchise legislation. Disclosure must be made in one document at one time, and must contain regulated information, not unlike the American experience. In those provinces without franchise legislation, the common law governs. There is no mandated form of disclosure required before parties can enter into franchise and related agreements. Franchisors that are members of the Canadian Franchise Association are subject to its Code of Ethics, which requires disclosure even in non-regulated provinces.

## LEGAL CONSIDERATIONS FOR AMERICAN FRANCHISORS

### KEY ELEMENTS OF STATUTORY DISCLOSURE INCLUDE:

Canadian legislation requires franchisors to disclose all material facts, i.e. facts which would influence whether a particular franchisee would buy a franchise or how much it would pay.

The document must be customized and site specific. It must tell the prospective franchisee all material facts relating to the specific opportunity being offered to it.

The document must be current as of the date of its delivery.

There is a 14-day cooling-off period before any money can be taken or any agreement relating to the franchise can be signed. Failing to disclose in a timely way or in a proper way gives rise to a statutory right of cancellation or rescission.

Potentially, disclosure may not just be pre-sale. It can also be required on renewal or extension (subject to statutory exemptions).

## LEGAL CONSIDERATIONS FOR AMERICAN FRANCHISORS

### ADDITIONAL CONCEPTS IN CANADIAN FRANCHISE LEGISLATION:

Franchisees have the right of association. Franchisors cannot act or threaten to act in a way which would impact a franchisee's right to associate with others.

Parties cannot contract out of the law of the province where the franchise is to be operated or pick a venue for dispute resolution outside of that province.

Both parties to the agreement are subject to the obligation to deal with each other fairly, including acting in good faith to each other and in accordance with reasonable commercial standards.

Franchisors have a limited ability to obtain releases of statutory rights.

### LEGISLATIVE INTERPRETATION

The interpretation of franchise legislation in Canadian courts has been relatively pro-franchisee, under the principle that the legislation was enacted to protect their interests. This treatment is best seen in the application of the remedy for no or bad disclosure. Under the legislation, franchisees who receive no disclosure or materially flawed disclosure can cancel or rescind their agreements within two years of entering into the agreements and can be entitled to statutory compensation.

The courts have interpreted the disclosure rules to include the concept of fatal flaws (for example, an absence of a signed certificate) and have interpreted the compensation sections in a manner which can produce a monetary windfall for franchisees. As well, those involved in signing the disclosure certificate and those involved in approving the sale or making misrepresentations to franchisees can be exposed to personal liability. There is insurance available to U.S.-based franchisors to cover some of these exposures.

The courts have interpreted the disclosure to include the concept of fatal flaws triggering the right to statutory remedies

## LEGAL CONSIDERATIONS FOR AMERICAN FRANCHISORS

### TRADEMARKS

Trademarks are controlled federally. A trademark registration in Canada is valid nationally. Franchisors are encouraged to register their marks should they expect to enter Canada; the registration process can begin before a franchisor enters the Canadian market. Canada protects against the registration of international "famous" marks, but apart from famous marks there are few restrictions on the registration of marks. The registration process is lengthy but not particularly costly where no oppositions are filed. In Canada, an application must describe the services and goods that word marks and design marks are capable of protecting. New legislation effective June, 2019 adopted the Nice Classification System. A registered mark under the new legislation will be valid for 10 years – a decrease from the previous term of 15 years. If a franchisor can demonstrate that its goods and services are sold in Canada, the party can receive common law protection under passing off laws.

### CHANGES IN TRADEMARK REGISTRATION IN CANADA

The amendments also included an expanded definition of a "trademark" that allows registration of various non-traditional marks, such as sounds, scents, tastes, and colours. The amendments allow anyone to register a trademark without having used it anywhere in the world. In a "first to file" jurisdiction such as Canada, this option gives foreign trademark owners a competitive edge by preventing others from entering the Canadian market with a confusingly similar mark. International brands should take note of these changes as they consider applying to register their trademarks north of the border.

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### COPYRIGHT

Copyright is an important matter for franchising companies given the significance of manuals in the operation of their systems. Most franchisors do not seek any specific registration protection for their manuals, although some are available. Copyright arises as a matter of law without registration. As such, copyright protection exists without registration.

## SECTOR CONSIDERATIONS

### Sector Considerations

#### CANNABIS

In 2019, the use of recreational cannabis was legalized throughout Canada. Each province, however, is responsible for the regulation of cannabis retail sales. Regulations are still being considered for the manufacturing and sale of consumables.

#### THIRD PARTY FOOD DELIVERY

Technology-based food delivery in Canada is increasing at significant rates year-over-year. Some estimates have stated the current value of food delivery sales at \$1.5 billion. Restaurant-to-consumer deliveries, as well as grocery and meal kit deliveries, are thriving. Various systems have established their own apps while others have signed on to such notable players as SkipTheDishes, UberEats, DoorDash and Foodora. Restaurant systems are becoming more sophisticated in their assessment of the cost and quality of the different providers. It is typical for a franchisor to negotiate the arrangement with one or more providers for its entire system.

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#### OTHER SECTOR CONSIDERATIONS

Brands which are concerned with dairy or poultry prices and sales of alcohol need to assess the Canadian system of quotas on dairy and poultry and more restrictive liquor laws.

### Retail Leasing in Canada

Location, even for a well-known brand, is no less important in Canada. Retail leasing rates vary according to location. Prime commercial rental unit rates can mirror those in large U.S. centres while regional rates can present excellent opportunities for brands that succeed with smaller demographics.

Canadian shopping malls are classified in much the same way as American centers. The International Council of Shopping Centers has a strong Canadian contingent. The largest and best urban shopping malls are in the hands of a relatively small number of landlords. Various real estate investment trusts, or REITs for short, also dominate regional mall holdings. Gaining a foothold into a shopping centre portfolio is best achieved by a company with a recognized brand and strong American performance. Various large U.S. retailers such as Starbucks have entered Canada primarily as corporate sites rather than through franchising. There is no particular advantage or disadvantage to this strategy. Franchising fundamentals hold true in Canada as they do in the U.S. Failures can be traced to a misunderstanding of the Canadian marketplace.

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Canadian shopping malls are classified in much the same way as American centers

### Choices for Franchising and Canadianizing of Documentation

Although several U.S. franchisors have entered Canada through master franchise relationships or through area development franchising, the majority of franchisors have entered using wholly owned Canadian entities or through direct franchising by the U.S. franchisor.

Given the proximity of most Canadian markets to the U.S., American franchisors have been able to support Canadian franchisees with their existing support teams typically augmented by individuals located in key Canadian markets.

There are few significant multi-unit franchisees in Canada. Canadian franchising typically features single unit or several unit operators, with some operating in various systems.

Once the selling process for the legislated provinces is understood, the contents of Canadian disclosure and franchise and related agreements are fairly similar. There are, however, some important differences in concepts, wording and recommended inclusions and exclusions to American documents. American franchisors and their U.S. counsel are highly discouraged from attempting to draft Canadian disclosure documents or unit franchise agreements.

Given the serious penalties for bad disclosure, most Canadian counsel will not do cursory reviews of an American attorney's attempt at creating a Canadian disclosure or franchise package. But Canadian franchise counsel are well adept to working with their U.S. counterparts to create timely and, in many cases, cost-efficient documentation for use in Canada.

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U.S. counsel are highly discouraged from attempting to draft Canadian franchise documents

### Financing

Several major Canadian franchisors are owned by private equity companies, as is the case with American-based franchisors which have entered Canada.

Financing for franchisees is available through a federal government small business loan program (SBL). With limited personal risk (a guarantee of 25% of the original amount borrowed), SBL financing (to a current limit of \$350,000) is available to a franchisee to purchase the assets necessary to build out a franchised unit. The program is administered by Canadian banks. The availability of SBL financing is a critical feature of franchise growth in Canada.

Financing for franchisees is available through a federal government small business loan program

### Conclusion

It has often been pointed out that there is a great divide between the American motto of "Life, Liberty and the Pursuit of Happiness" and the Canadian motto of "Peace, Order and Good Government." Although the origins of our two nations' independence from Britain were founded on different circumstances, the borders north to south are as easily traversed for purposes of travel as they are for franchising. The geographic regions of Canada correspond to those of our American cousins. For any franchising company which sees the U.S. north as a viable market for its goods and services, there is a market across the border that is probably just as viable with modest costs of entry.



## Thinking of expanding into Canada?

Let the franchise law experts at Sotos LLP drive your brand to success in this dynamic market right next door. We are Canada's leading franchise law firm, with deep expertise in every franchising sector and more franchising experience than any other law firm in the country. Over the last 40 years, we've guided hundreds of franchise businesses through Canada's legal franchise framework. Our teams are dynamic, passionate about franchising and always striving for the best – much like the businesses we serve.

**Contact one of our franchise sector leads to learn more about bringing your business to Canada.**

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**For further information on how we can help your business expand into Canada visit [SotosLLP.com](http://SotosLLP.com) or please contact**

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