Ontario franchise law amendments come into force

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Franchisors offering franchises in Ontario breathed a collective sigh of relief on September 1, 2020, when the long-awaited amendments to the *Arthur Wishart Act (Franchise Disclosure), 2000* (the AWA) came into effect. The amendments were introduced on November 1, 2017, when the Ontario legislature passed the *Cutting Unnecessary Red Tape Act, 2017*, but the legislation remained unproclaimed until now. The amendments clarify some unclear provisions in the legislation and add some welcome options for pre-disclosure contracting.

Carve-out from the obligation to disclose for confidentiality and site-selection agreements

Section 5(1)(a) of the AWA requires that a franchisor provide a prospective franchisee with a disclosure document not less than 14 days before the prospective franchisee signs a franchise agreement or any agreement relating to the franchise. The AWA has a broad definition of "franchise agreement," which would include a confidentiality agreement and site-selection agreements. Accordingly, this section has prevented franchisors from requiring prospective franchisees to sign confidentiality agreements to protect the franchisor's confidential information that must be shared with a prospective franchisee via a disclosure document and other pre-contractual discussions, or to settle on a specific site for the franchise.

The amendments now make it possible for a franchisor to ask a franchisee to sign either or both of a confidentiality agreement and a site-selection agreement during or before the 14-day disclosure period. The confidentiality agreements must meet certain criteria. They cannot

- impose confidentiality obligations on the franchisee in respect of information that is or comes into the public domain other than as a result of a contravention of the agreement, is disclosed to any person other than as a result of a contravention of the agreement or is disclosed with the consent of all the parties to the agreement; or
- prohibit the disclosure of information to an organization of franchisees, other franchisees of the same franchise system or a franchisee's professional advisors.

There are no express restrictions on the terms of a site-selection agreement, but the exemption applies if the agreement "only" contains terms that "designate a location, site or territory for a prospective franchisee."

These changes align the AWA with what is typically seen in the franchise legislation of the

other provinces.

Deposit payments

Section 5(1)(b) of the AWA prevents a franchisor from receiving any consideration before the end of the 14-day disclosure waiting period, which prior to the amendments prohibited the payment of a deposit to the franchisor before or during this period. The amendments provide an exclusion for deposit payments that

- do not exceed 20% of the franchisee fee (to a maximum of $100,000);
- are refundable without any deductions; and
- are given under an agreement that in no way binds the prospective franchisee to enter into a franchise agreement.

Clarifying the availability of exemptions

The amendments also clarify and revise a number of existing exemptions to the obligation to provide a disclosure document under the AWA, with the changes aimed at giving franchisors greater clarity about the circumstances in which the exemptions apply.

The rarely used exemption in section 5(7)(b) of the AWA is available to franchisors disclosing to a prospective franchisee who has been an officer or director of the franchisor or of the franchisor's associate for at least six months. Some franchisee counsel have argued that this exemption is not clear and does not extend to the principal shareholder of a corporate franchisee where that principal was a director or officer of the franchisor. The basis of the argument is that the grant of the franchise is to the corporate franchisee, which is a separate legal person from the natural person who was the director or officer. This argument has not been tested in court, but leads to the conclusion that this exemption could never be used in connection with the grant of a franchise to a franchisee other than a natural person. It seems unlikely that this was the legislature's intention.

The amendments address this uncertainty by clarifying that the exemption is available where the grant of the franchise is to a person for the person's own account or to a corporation that the person controls if the person has been an officer or director of the franchisor or of the franchisor's associate for at least six months and is currently such an officer or director, or was an officer or director of the franchisor or of the franchisor's associate for at least six months and not more than four months have passed since the person was such an officer or director. With this new language, franchisors should be more confident when relying on this exemption.

Furthermore, both the small and large investment exemptions have been reworked under the amendments to make each more clear and accessible. The small investment threshold has been increased to $15,000 (from $5,000), while the large investment exemption has been lowered to $3,000,000 (from $5,000,000). At present the small investment exemption refers to the "total annual investment" of the franchisee and the large investment exemption refers to the "acquisition amount." The amendment simplifies the language in both exemptions by referring to the single concept of a "total initial investment," which is specified to be all of the franchisee's costs associated with establishing the franchise. A broad list of the types of costs associated with the total initial investment are also set out and include the amount of any deposits or franchise fees; an estimate of the costs for inventory, leasehold improvements, equipment, leases, rentals and all other tangible and intangible property necessary to establish the franchise; and any other costs or estimates of costs associated with the establishment of the franchise, including any payment to the franchisor, whether direct or

indirect, required by the franchise agreement.

Finally, the exemption in section 5(7)(e) of the AWA (commonly known as the "fractional franchise" exemption) is available in connection with the grant of a franchise to a person to sell goods or services within a business in which that person has an interest if the sales arising from those goods or services *during the first year of operation of the franchise*, as anticipated by the parties or that should be anticipated by the parties at the time the franchise agreement is entered into, do not exceed 20% of the total sales of the business *during that year* (emphasis added). The amendments provide this additional emphasized language, clarifying that the fractional sales requirement is to be applied in relation to the anticipated sales of the franchise during the first year of operation. Prior to the amendments, this timeframe was not clear.

Statement of material change

The amendments now also set out what must be included in a statement of material change. Specifically, a statement of material change must include a certificate certifying that the statement of material change contains no untrue information, representations or statements, whether of a material change or otherwise, and includes every material change. Moreover, the certificate has to be signed and dated

- by the franchisor personally, in the case of an unincorporated franchisor,
- by one officer or director, in the case of a corporate franchisee with only one officer or director, and
- by two or more officers or directors, in the case of a corporate franchisee with two or more officers or directors.

Although the inclusion of these items in statements of material change has been standard practice for many franchisors for years, the AWA now affirms this approach.

Financial statements

The amendments expand the scope of the standard of audit or review engagement for the financial statements that must be included in the disclosure document. Now, the disclosure document must include either

- an audited financial statement for the most recently completed fiscal year of the franchisor's operations, prepared in accordance with generally accepted auditing standards as set out in the *CPA Canada Handbook – Assurance*, by the Auditing Standards Board of the American Institute of Certified Public Accountants or the Public Company Accounting Oversight Board of the United States, or by the International Auditing and Assurance Standards Board, as applicable; or
- a financial statement for the most recently completed fiscal year of the franchisor's operations, prepared in accordance with generally accepted accounting principles that meet the review and reporting standards applicable to review engagements as set out in the *CPA Canada Handbook – Accounting*, by the Financial Accounting Standards Board of the United States, or by the International Accounting Standards Board, as applicable.

If you would like to understand how the Ontario amendments may impact your day-to-day disclosure practices, please contact any member of the Osler Franchise Group.