

CANADIAN FRANCHISE DISCLOSURE STATUTES: DISCLOSURE OF REBATES RECOMMENDATION

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RECOMMENDATION

The Alberta, Ontario and PEI franchise statutes each require a disclosure document to contain prescribed, minimal disclosure concerning rebates, commissions, payments and other benefits¹ that the franchisor or franchisor's associate receives or may receive as a result of the purchase of goods or services by franchisees.²

Alta. Reg. 240/95 requires that the disclosure document state whether or not there are any volume rebates and whether or not they are shared with franchisees. O.Reg. 581/00 adds to the Alberta disclosure a requirement to describe any franchisor "policy" (whatever that means) regarding volume rebates. EC2006-232 adds to Ontario's required disclosure a requirement to describe any franchisor practices regarding volume rebates.

In practice, most Canadian franchisors receive volume rebates, and depending on the size of the franchise system, these rebates can amount to hundreds of thousands or millions of dollars. While some franchisors pass some or all volume rebates on to their franchisees (either directly or indirectly),³ many choose to retain the rebates for themselves.

While it certainly is important for a franchisor to disclose to its prospective franchisees both the existence of volume rebates and how the franchisor proposes to treat them,⁴ in our view a franchisor who

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¹ We will refer to these, collectively, simply as "volume rebates".

² Alberta: *Franchises Act*, R.S.A. 2000, c.F-23, s. 4(3)(a) ["Alberta Act"] and Alta. Reg. 240/95, s. 12; Ontario: *Arthur Wishart Act (Franchise Disclosure)*, 2000, S.O. 2000, c.3, s. 5(4)(a) ["Ontario Act"] and O. Reg. 581/00, s. 8; Prince Edward Island: *Franchises Act*, S.P.E.I. 2005, c. 36, s. 5(4)(a) ["PEI Act"] and P.E.I. Reg. EC2006-232, Schedule I, s. 10.

³ For example, by depositing them into one or more pooled advertising funds.

⁴ See *Jirna Ltd. v. Mr. Donut of Canada Ltd.*, [1970] 3 O.R., 629 (H.C.J.); [1972] 1 O.R. 251 (C.A.); [1975] 1 S.C.R. 2.

proposes to retain for itself some or all of these rebates ought also disclose whether or not they amount to a significant portion of the franchisor's total revenue stream. Such disclosure is a requirement under both Item 8 of the 1993 UFOC Guidelines published by the North American Securities Administrators Association,⁵ and under the original FTC Rule and the proposed amendments to the Rule.⁶ However in our view both the Guidelines and the Rule go too far, since they require a franchisor to disclose both its total dollar revenue and the dollar revenue that it receives from volume rebates. In our view it would be sufficient simply to require, in addition to the disclosure requirements in the Ontario and PEI Acts, that:

- a) if the volume rebates revenue received by the franchisor or an affiliate of the franchisor and retained for itself during either or both of its two most recently completed fiscal years exceeds 5% of the franchisor's or affiliate's total revenue for such year, then the franchisor disclose for *each* of those two years such annual volume rebates revenue as a percentage of such total annual revenue, and
- b) if the volume rebates revenue that the franchisor estimates it or its affiliate will receive and retain for itself during its current fiscal year exceeds 5% of franchisor's or affiliate's estimated total revenue for that year, then the franchisor disclose such estimated volume rebates revenue as a percentage of such total estimated revenue.

The amounts referred to in (a) should be based on the franchisor's or affiliate's annual financial statement for the year in question, that statement being prepared in accordance with either:

- (1) generally accepted auditing standards that are at least equivalent to those set out in the *Canadian Institute of Chartered Accountants Handbook*, or
- (2) generally accepted accounting principals that are at least equivalent to the review and reporting standards applicable to

⁵ Item 8D and Item 8 Instructions iii, vii and ix. The UFOC Guidelines may be downloaded at:

<www.nasaa.org/content/Files/UniformFranchiseOfferingCircular.doc>.

⁶ *Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures*, 16 C.F.R. Part 436, §436.1(a)(11), and proposed revised Rule 436.5(h) which adopts the rebates disclosure requirements in UFOC Item 8.

2008]

Disclosure of Rebates Recommendations

421

review engagements set out in the *Canadian Institute of Chartered Accountants Handbook*.