



**SUBMISSIONS OF THE CANADIAN BAR ASSOCIATION
(BRITISH COLUMBIA BRANCH)**

TO THE

BRITISH COLUMBIA LAW INSTITUTE

ON THE

CONSULTATION PAPER ON A

***FRANCHISE ACT*
FOR
BRITISH COLUMBIA**

Issued By:

Canadian Bar Association
British Columbia Branch
Special Committee
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PREFACE

Formed in 1896, the purpose of the Canadian Bar Association (British Columbia Branch) (the “CBABC”) is to:

- enhance the professional and commercial interests of our members;
- provide personal and professional development and support for our members;
- protect the independence of the judiciary and the Bar;
- promote access to justice;
- promote fair justice systems and practical and effective law reform; and
- promote equality in the legal profession and eliminate discrimination.

The CBA nationally represents approximately 38,000 members and the British Columbia Branch itself has over 6,900 members. Our members practice law in many different areas. The CBABC has established 77 different sections to provide a focus for lawyers who practice in similar areas to participate in continuing legal education, research and law reform. The CBABC has also established standing committees and special committees from time to time.

This submission was prepared by a special committee, composed of members of the CBABC Legislation and Law Reform Committee, interested lawyers and CBA members (the “Special Committee”). The comments expressed in this submission reflect the views of the Special Committee only and are not necessarily the views of the CBABC as a whole.

The members of the Special Committee are:

- Rose Shawlee, Special Committee Chair, member of the CBABC Legislation and Law Reform Committee (Richards Buell Sutton, Vancouver, British Columbia);
- Andrew Brunton (Pushor Mitchell, Kelowna, British Columbia);
- Edward (Ned) Levitt (Dickinson Wright, Toronto, Ontario);
- Blair Rebane (Borden Ladner Gervais, Vancouver, British Columbia);
- Peter V. Snell (Gowlings, Vancouver, British Columbia);
- John Sotos (Sotos LLP, Toronto, Ontario);
- Tony Wilson (Boughton Law Corporation, Vancouver, British Columbia); and
- Sze-Mei Yeung (Richards Buell Sutton, Vancouver, British Columbia).

Stuart Rennie, CBABC Legislation and Law Reform Officer, assisted the Special Committee.

EXECUTIVE SUMMARY

The Special Committee appreciates the opportunity to comment on this important area of law reform and agrees with the British Columbia Law Institute (the “BCLI”) that the BC government should enact a *Franchise Act* for British Columbia.

The Special Committee considered the BCLI’s 16 tentative recommendations in its Consultation Paper and agrees unanimously with all of the BCLI’s tentative recommendations, **except** for:

- Recommendation 5 on substantial compliance with a disclosure document;
- Recommendation 6 on refundable deposits;
- Recommendation 8 on alternative channels of distribution clause;
- Recommendation 9(c) on email acknowledgement; and
- Recommendation 12 using “franchising agreement” vs. Recommendation 13 using “franchise agreement”.

The Special Committee has other matters it wishes the BCLI to consider including in the proposed BC *Franchise Act*:

- definition of “franchise” to exclude classic distribution arrangements;
- definition of “franchise agreement”;
- exemption for minimal investments;
- exemption for large investments;
- if term of contract less than 1 year, no fee but ongoing royalties exempt from disclosure; and
- financial statement exemption.

SUBMISSIONS

Introduction

In March 2013, the BCLI released its Consultation Paper on a *Franchise Act* for British Columbia (the “Consultation Paper”).¹

In its Consultation Paper, the BCLI made 16 tentative recommendations:²

1. British Columbia should enact franchise legislation.
2. Subject to Tentative Recommendation 3, franchise legislation in British Columbia should be modelled generally on the Uniform Franchises Act.
3. British Columbia franchise legislation should not provide for mandatory mediation on the demand of one party to a franchise agreement.
4. A disclosure document provided to a prospective franchisee in British Columbia should contain the following statement:

Mediation is a voluntary process to resolve disputes with the assistance of an independent third party. Any party may propose mediation or other dispute resolution process in regard to a dispute under the franchise agreement, and the process may be used to resolve the dispute if agreed to by all parties.

¹ See http://www.bcli.org/sites/default/files/franchise_act_consultation_paper_mar13.pdf.

² *Supra*, Appendix A, pages 95-98.

5. British Columbia franchise legislation should provide that a disclosure document or statement of material change

(a) is valid if the disclosure document or statement of material change substantially complies with the Act and regulations; and

(b) is valid despite the presence of a technical irregularity, error, or defect in form that does not affect the substance of the document.

6. It should be permissible for a franchisor to request and receive a fully refundable deposit from a prospective franchisee before delivering a disclosure document if the deposit

(a) does not exceed an amount prescribed by regulation;

(b) is refundable without any deductions if the prospective franchisee does not enter into a franchise agreement; and

(c) is given under an agreement with the franchisor concerning the deposit that does not obligate the prospective franchisee to enter into any franchise agreement.

7. A franchisor should be required to state in the disclosure document whether or not exclusive territory is granted under the franchise being offered.

8. A franchisor should be required to disclose whether it reserves the right to market directly goods or services of the same kind as are to be sold or distributed under the franchise being offered, and the channels of distribution that the franchisor uses or may use, including but not limited to telephone, catalogue, and internet sales, and outlets that the franchisor operates or intends to operate directly.

9. Delivery of a disclosure document or statement of material change to a prospective franchisee by electronic means, or in a machine-readable form, should be permissible provided that:

(a) the disclosure document or statement of material change meets the requirements of sections 6 and 7 of the *Electronic Transactions Act*;

(b) the disclosure document or statement of material change contains no links to or from external documents or content; and

(c) the recipient acknowledges in writing the receipt of the disclosure document or statement of material change, which acknowledgement may be in the form of an e-mail message or other electronic transmission to the franchisor.

10. A franchisee's statutory right of action for misrepresentation under British Columbia franchise legislation should extend to misleading or inaccurate information in a financial or earnings projection provided by the franchisor or franchisor's associate to the franchisee before the franchisee entered into a franchising agreement, unless the projection has a reasonable basis and is accompanied by cautionary language stating that:

(a) the projection is made with respect to the future;

(b) the projection is based on assumptions about future economic, fiscal, and other conditions; and

(c) actual financial results may vary significantly from those predicted in the projection.

11. A franchisor should be able to use as its disclosure document under British Columbia franchise legislation a document that is prepared in compliance with the franchise disclosure requirements under the laws of another jurisdiction, if the franchisor includes additional information with that document as is necessary to comply with the franchise disclosure requirements of British Columbia.

12. Section 11 of the *Uniform Franchises Act* should be amended in a version of the Act enacted in British Columbia so as to apply with respect to “claims arising under a franchising agreement,” rather than only to claims enforceable under the Act.

13. Section 11 of the *Uniform Franchises Act* should be amended in a version of the Act enacted in British Columbia so as to extend to terms mandating an extra-provincial venue for arbitration of a claim arising from a franchise agreement.

14. A version of the *Uniform Franchises Act* enacted in British Columbia should specify that a franchisee is not required to elect between statutory rescission under the Act and the statutory rights of action for damages, but is not entitled to be indemnified by way of damages in respect of a loss recovered through rescission.

15. British Columbia franchise legislation should state that the presumption of deemed reliance by a franchisee on a disclosure document or statement of material change operates conclusively, except where it is proved that the franchisee acquired the franchise with actual knowledge of a misrepresentation, or of a material change occurring between the delivery of a disclosure document and the execution of a franchise agreement that was not described in a statement of material change given to the franchisee within the time required by the legislation, as the case may be.

16. British Columbia franchise legislation should indicate clearly that the prohibition on waivers and releases of statutory rights (in the provision corresponding to section 12 of the *Uniform Franchises Act*) does not apply to a post-dispute settlement agreement.

Unanimity With Specified BCLI Tentative Recommendations

The Special Committee considered the BCLI's 16 tentative recommendations and agrees unanimously with all of the BCLI's tentative recommendations, **except** for:

- Recommendation 5 on substantial compliance with a disclosure document;
- Recommendation 6 on refundable deposits;
- Recommendation 8 on alternative channels of distribution clause;
- Recommendation 9(c) on email acknowledgement; and
- Recommendation 12 using "franchising agreement" vs. Recommendation 13 using "franchise agreement".

The Special Committee also concluded that additional recommendations should be considered, detailed commencing on page 19 of these submissions.

BCLI Recommendation 5: Substantial Compliance With A Disclosure Document

While a majority of 7 of 8 members of the Special Committee supports Recommendation 5 that there be a “substantial compliance” standard included in the proposed BC franchise legislation regarding disclosure documents and statements of material change, a minority of 1 member of the Special Committee does not. The view of the Special Committee's majority is that strict liability imposes too high a standard and burden on franchisors. The aim of the legislation is, and the Special Committee understands it to be, to protect vulnerable franchisees. Strict liability would exceed this and, instead, open franchisors to abuse by franchisees.

The Alberta Court of Appeal's decision in *Hi Hotel Limited Partnership v. Holiday Hospitality Franchising Inc.*, has been cited as a source of guidance on “substantial compliance”.³ However, the commentary provided by the appeal court was merely obiter and not binding. Aside from providing some possible scenarios as to when substantial compliance could potentially be met, there was no clear rule on what constitutes “substantial compliance.” Manitoba's legislation provides slightly more guidance than Alberta. Section 5(10) of *The Franchises Act* of Manitoba states that substantial compliance is met so long as it is only a “technical irregularity or mistake not affecting the substance of the document”.⁴ The minority and majority of the Special Committee differ as the utility of the guidance these perspectives offer in practice.

³ 2008 ABCA 276 (CanLII) (<http://canlii.ca/t/208h3>).

⁴ CCSM c F156 (<http://canlii.ca/t/51wps>).

The Special Committee minority's view, 1 of 8 members, is that including a "substantial compliance" standard in the BC franchise legislation will lead to greater regulatory uncertainty for, and impose undue financial strain upon, franchisees and therefore the strict liability standard should be pursued instead. With the exception of Alberta and Manitoba, provinces have not included such language in their legislation and, informed by the experience litigating franchising matters in Canadian courts, the minority of the Special Committee believes a strict liability standard imposed upon franchisors is necessary for ensuring the primary legislative objective of prospective franchisee/franchisee protection is upheld. On the basis that franchise legislation is intended to be remedial, the minority of the Special Committee believes that the hardship caused by any failure of a franchisor to comply with technicalities is outweighed by the need for protecting unsophisticated prospective franchisees, who could find themselves incapable of enforcing their rights due to the significant costs required to determine the meaning of "substantial compliance."

BCLI Recommendation 6: Refundable Deposits

The Special Committee did not agree on refundable deposits as proposed. The Special Committee agreed that litigation to recover a deposit is expensive and time-consuming.

Of the Special Committee:

- 3 of the 8 members were in favour of a refundable deposit set by regulation;
- 1 member was against any refundable deposit set by regulation; and
- 4 of the 8 members were in favour of a trust model, having the deposit either held in trust by legal counsel or independent adviser, akin to the model used for deposits in real estate transactions or a deemed trust to be created by statute.

BCLI Recommendation 8: Alternative Channels Of Distribution Clause

The Special Committee does not agree to include Recommendation 8 in the proposed BC franchise legislation.

After considerable review, the Special Committee was unanimously in agreement that the obligations in Recommendation 8 are covered as a material fact and, as a result, not needed.

Instead of Recommendation 8, the Special Committee unanimously recommends that BC adopt a regulation for distance sales similar to that in the New Brunswick Disclosure

Document Regulation (NB Reg 2010-92) under the *Franchises Act*, SNB 2007, c F-23.5.⁵

Section 14 of Part 3 of Schedule A to the New Brunswick Disclosure Document Regulation (NB Reg 2010-92) requires the franchisor, in the disclosure document, to describe the franchisor's policies and practices relating to Internet sales or other distance sales by a franchise, distributor, licensee or business.

The advantage to having a BC regulation for distance sales is that it clarifies these activities. Another advantage is that it harmonizes BC with similar regulations in New Brunswick and Manitoba.

BCLI Recommendation 9(c): Email Acknowledgement

The Special Committee agrees with Recommendation 9(a) that a disclosure document or statement of material change must meet the requirements of the *Electronic Transactions Act*. As well, the Special Committee agrees with Recommendation 9(b) that the disclosure document or statement of material change must not have links to external documents or content.

⁵ See <http://canlii.ca/t/ktwg>.

The Special Committee has concerns about email acknowledgement in Recommendation 9(c). The Special Committee was unable to reach a unanimous opinion, reflecting, the Special Committee expects, the divergent positions likely to be encountered if implemented.

Recommendation 9(c) would place a positive obligation to acknowledge. If a party is noncompliant, this creates a problem, especially since it raises issues of proof of receipt of the acknowledgement when made by electronic means.

Of the Special Committee, 3 of the 8 members did not express an opinion, so:

- 2 of the remaining 5 members do not support Recommendation 9(c) on the basis that it gives protection to the franchisee at the unnecessary expense of the franchisor;
- 3 of the remaining 5 members support Recommendation 9(c). Two reasons for support were articulated: first, consistency with other provinces such as Manitoba, New Brunswick and Prince Edward Island, and second, anticipation that, in practice, franchisor's counsel likely will, in his or her e-mail to the prospect, indicate what is enclosed (the way a receipt is worded), and may simply require the franchisee prospect, by return e-mail to say: "I confirm that I have received these documents referred to in the franchisor's e-mail" or something to that effect that includes the franchisee prospect's name.

BCLI Recommendation 12 Using “Franchising Agreement” Vs. Recommendation 13 Using “Franchise Agreement”

The Special Committee was uncertain whether or not the Consultation Paper was in error in its use in Recommendation 12 of “franchising agreement” vs. “franchise agreement” in Recommendation 13.

In the *Uniform Franchises Act*, “franchise agreement” is a defined term, while “franchising agreement” is not. The use of these two different terms causes uncertainty.

In order for certainty, the Special Committee unanimously recommends that reference to “franchising agreement” in Recommendation 12 be replaced with “franchise agreement”.

Other Matters To Consider For The BCLI

The Special Committee has other matters it wishes the BCLI to consider including in the proposed BC franchise legislation. Some of these matters are recommendations by the Special Committee while others are raised without recommendation.

These matters are not included in the Consultation Paper. These matters are:

- definition of “franchise” to exclude classic distribution arrangements;
- definition of “franchise agreement”;

- exemption for minimal investments;
- exemption for large investments;
- if term of contract less than 1 year, no fee but ongoing royalties exempt from disclosure; and
- financial statement exemption.

Definition of “Franchise”

A majority, 7 of 8 members of the Special Committee believes that the definition of “franchise” needs to be clarified to provide that classic distribution arrangements are not franchises and do not attract the operation of the legislation. For example, this would apply where there are no ‘hidden’ royalties in the purchase price for goods.

The rationale for this clarification is that Ontario is the only province in Canada that does not exempt classic distribution arrangements from disclosure requirements. The need for, or benefit of, disclosure is not as significant in the distribution industry as in franchising and, further, BC's exclusion of classic distribution arrangements is in line with the aim of consistency within Canada.

The majority of the Special Committee therefore recommends that the definition of “franchise” be modified to exclude classic distribution agreements.

Definition Of “Franchise Agreement”

A majority, 7 of 8 members of the Special Committee, believes that the definition of “franchise agreement” is overly broad and captures things it should not. The definition of “franchise agreement” should not apply to ancillary documents signed after the franchise agreement is signed. Such agreements may be entered into during the course of a franchise relationship, but since there is no fresh grant of a franchise being made, there should be no duty to disclose in those circumstances.

A minority, 1 of 8 members of the Special Committee, believes that the definition of “franchise agreement” should apply to ancillary documents signed after the franchise agreement is signed on the basis that the disclosure requirements under the legislation should be complied with if subsequent documents are signed.

The Special Committee recommends that BCLI consider whether the definition of “franchise agreement” should be limited to a grant of a franchise only, and specifically exclude related or ancillary documents that are executed after the original franchise agreement has been signed.

Exemption For Minimal Investments

A majority of the Special Committee, 7 of 8 members, believes that there should be an exemption for minimal investments.

Currently, "investment" is unclear and would benefit from clarification in the draft legislation itself. Is it only capital investment or does it include operational expenses such as payment of rent? Does it make a difference if the operational expenses, such as rent, are paid from the cash flow of the business?

It was determined unanimously that without this clarification it was unlikely that, in practice, the exemption could be used because a franchisor would be exposed to uncertainty as to whether the exemption was applicable. As a result, both franchisors and franchisees would be subjected to the complete disclosure process notwithstanding the amount of the investment, often acting as a deterrent for a franchisee who isn't interested in that cumbersome process where such a limited investment is proffered.

A majority, 7 of 8 members, of the Special Committee recommends that a recommendation be made that there be an exemption for minimal investments, with the minimal investment capped at \$5,000.

Exemption For Large Investments

The Special Committee unanimously believes that there should be an exemption for large investments.

Under section 5(8)(g) of the *Uniform Franchises Act*, the exemption for investments applies if the prospective franchisee is required to make a total annual investment to acquire and operate the franchise in an amount that does not exceed the prescribed amount.⁶

The Special Committee unanimously believes that the words “acquire and operate” need to be clarified. For example, does “acquire and operate” include ongoing operational expenses? The rationale for this clarification is housekeeping. The Special Committee unanimously recommends that the large investment be set at \$5 million or more.

A minority of the Special Committee, 1 of 8 members, believes that these changes should apply only to the initial investment, not to ongoing investments.

Another minority of the Special Committee, 1 of 8 members, believes that the exemption for large investments does not need to be clarified at all because the exemption should include all monies.

⁶ See <http://www.ulcc.ca/en/uniform-acts-new-order/current-uniform-acts/670-franchises/1440-franchises-act-and-regulations>.

The Special Committee suggests that BCLI consider whether a recommendation should be made on this issue.

Short Term Contracts (1 Year or less) with No Fee Exemption From Disclosure

The Special Committee unanimously recommends that the BC franchise legislation include an exemption from disclosure requirements that is similar in form to the existing exemption under Ontario franchise legislation, for short term contracts with a term of 1 year (or less), which do not require any upfront initial fees to be paid by the franchisee, provided that this is a one-time exemption only, and does not extend to any renewals of such contract.

By way of example, in Ontario we understand that this exemption is intended to apply to College Pro summer painters, food trucks and other short-term or seasonal businesses, for which it would be onerous and inappropriate to impose franchise disclosure requirements upon. The rationale for excluding renewals is to prevent parties from unfairly seeking to take advantage of such exemption to avoid disclosure obligations.

Financial Statement Exemption

The Special Committee considered the financial statement exemption regarding asset sales and reorganizations.

The Special Committee discussed section 8 of New Brunswick's Disclosure Document Regulation (NB Reg 2010-92). In that section 8, New Brunswick provides that a franchisor is exempt from the requirement to include financial statements in a disclosure document if specified conditions apply, such as audited financial statements and a minimum number of franchisees engaged in business in Canada for 5 years prior to the date of the disclosure document. This section 8 could apply to both an asset sale and a reorganization.

The Special Committee recommends that BCLI may wish to consider whether B.C. should adopt language similar to that under section 8 of New Brunswick's Disclosure Document Regulation. If the BCLI considers such an exemption, BCLI may wish to consider that the net worth should be greater than the amount set out in New Brunswick's Disclosure Document Regulation. The Special Committee on this point reached no majority decision.

SUMMARY OF RECOMMENDATIONS

In these Submissions, the Special Committee has made the following recommendations:

RECOMMENDATION #1: *Franchise Act* For British Columbia

The Special Committee agrees unanimously with the BCLI that the BC government should enact a *Franchise Act* for British Columbia.

RECOMMENDATION #2: Unanimity With Specified BCLI Tentative Recommendations

The Special Committee agrees unanimously with all of the BCLI's 16 tentative recommendations, **except** for:

- Recommendation 5 on substantial compliance with a disclosure document;
- Recommendation 6 on refundable deposits;
- Recommendation 8 on alternative channels of distribution clause;
- Recommendation 9(c) on email acknowledgement; and
- Recommendation 12 using “franchising agreement” vs. Recommendation 13 using “franchise agreement”.

RECOMMENDATION #3: BCLI Recommendation 5 Substantial Compliance With A Disclosure Document

A majority of the Special Committee supports BCLI Recommendation 5 that there be a “substantial compliance” standard included in the proposed BC franchise legislation regarding disclosure documents and statements of material change.

RECOMMENDATION #4: BCLI Recommendation 6 Refundable Deposit

A majority of the Special Committee supports BCLI Recommendation 6 that there be a refundable deposit set by regulation.

RECOMMENDATION #5: BCLI Recommendation 8 Alternative Channels Of Distribution Clause

The Special Committee is unanimous and does not agree with BCLI Recommendation 8 to include an alternative channel of distribution clause in the recommended BC *Franchise Act*. Instead of BCLI Recommendation 8, the Special Committee unanimously recommends that BC adopt a regulation for distance sales similar to that in the New Brunswick Disclosure Document Regulation under the New Brunswick *Franchises Act*.

RECOMMENDATION #6: BCLI Recommendation 9(c) Email Acknowledgement

The Special Committee agrees unanimously with BCLI Recommendation 9(a) and (b) regarding requiring a disclosure document or statement of material change to comply with the *Electronic Transactions Act* and not have links to external documents or content. The Special Committee was evenly split on BCLI Recommendation 9(c) to require proof of receipt of the acknowledgement when made by electronic means.

RECOMMENDATION #7: BCLI Recommendation 12 Using “Franchising Agreement” vs. Recommendation 13 Using “Franchise Agreement”

The Special Committee unanimously recommends that, in order to be certain, the reference to “franchising agreement” in Recommendation 12 be replaced with “franchise agreement”.

RECOMMENDATION #8: Definition Of “Franchise”

A majority of the Special Committee recommends that the definition of "franchise" be modified to exclude classic distribution agreements.

RECOMMENDATION #9: Definition Of “Franchise Agreement”

The Special Committee recommends that BCLI consider whether the definition of “franchise agreement” should be limited to a grant of a franchise only, and specifically

exclude related or ancillary documents that are executed after the original franchise agreement has been signed.

RECOMMENDATION #10: Exemption For Minimal Investments

A majority of the Special Committee recommends that there be an exemption for minimal investments, with the minimal investment capped at \$5,000.

RECOMMENDATION #11: Exemption For Large Investments

The Special Committee unanimously recommends that there be an exemption for large investments, set at \$5 million or more and that the words “acquire and operate” be clarified.

RECOMMENDATION #12: Short Term Contracts (1 Year Or Less) With No Fee Exemption From Disclosure

The Special Committee unanimously recommends that the BC franchise legislation include an exemption from disclosure requirements that is similar in form to the existing exemption under Ontario franchise legislation, for short term contracts with a term of 1 year (or less), which do not require any upfront initial fees to be paid by the franchisee, provided that this is a one-time exemption only, and does not extend to any renewals of such contract.

RECOMMENDATION #13: Financial Statement Exemption

The Special Committee recommends that BCLI may wish to consider whether B.C. should adopt language similar to that under section 8 of New Brunswick's Disclosure Document Regulation, though the Special Committee on this point reached no majority decision.

CONCLUSION

The Special Committee is pleased to make these submissions in this important area of law needing effective and efficient law reform.

We look forward to discussing these important matters further to assist the BCLI in drafting its final report. Communications in this regard can be directed to:

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