



# Bullet-Proofing Your Disclosure Documents

*Joseph Adler*

*May 31, 2010*



I disclose.  
Therefore I am.

2010, Unnamed Franchisor



# Overview

- Summary of Franchise Disclosure Laws
- Court Trends
- Top Disclosure Tips
  - Best practices for preparing and issuing disclosure documents
  - Traps to avoid
  - A survey of some recent cases regarding franchise disclosure



# Overview - Disclosure Tips

- Pre-disclosure issues
  - Collecting information
  - Preparing disclosure document (DD)
- Delivery of the DD issues
  - To whom, how, and when?
- Post-disclosure issues
  - Post-disclosure disclosure
  - Rectifying deficient disclosure



# Canadian Franchise Disclosure Jurisdictions

- Ontario
- Alberta
- PEI
- New Brunswick
- Manitoba (Draft)



# Disclosure Rules

- 14 day rule
- 60 day right of rescission
  - Late disclosure
  - Deficient disclosure
- 2 year right of rescission – no disclosure
- Right of action for damages



# Court Trends

- Courts are liberally interpreting franchise disclosure statutes in favour of franchisees
- Freedom of contract is yielding to consumer protection (*Hi Hotels*)
- Courts are addressing the “disparity of knowledge” characteristic of franchisor-franchisee relationships
- Dollar It: “The purpose of the legislation is to protect Zees”!



# Top 34 Disclosure Tips & Issues





## #1: Consider Variations as Among Disclosure Statutes

- Earnings projections
- Electronic delivery -PEI
- Guarantees & security interests – PEI
- Order of disclosure required – Ontario
- Substantial compliance - Alta, PEI, MB



## #1: Consider Variations as Among Disclosure Statutes

- Renewal exemption does not require material changes since initial or previous renewal -Alta
- Use of wraparounds – Alta and PEI
- Variations in non-application of statutes and disclosure exemptions



## #2: Consider Disclosure Obligation Exemptions & Exclusions

- Examples:
  - Payment of a fully refundable deposit
    - Not > 20% of initial franchise fee – Alta
    - “The payment of any consideration” – MB Act)will not offend the 14-day rule
  - Agreements that maintain confidentiality or designate territory or location ≠ Franchise agreements – Alta, PEI, NB, MB



## #3: Presentation of Disclosure Document

- Wraparounds
  - Acceptable in Alta and PEI
  - Not acceptable in Ontario?
  - May contravene the “clear & concise” rule
  - Tutor Time- use of an UFOC unacceptable?
  
- S.6 of Ont Regs: “presented together in one part of the document”



## #4: Providing “Voluntary” Disclosure in Non-Regulated Provinces

- CFA Code of Ethics
  - Disclosure mandatory
- Methods of providing disclosure in non-regulated provinces
- Amend DD where appropriate or provide disclaimer



## #4: Providing “Voluntary” Disclosure in Non-Regulated Provinces

- Disclaimer –
  - DD provided for informational purposes only
  - No rights accrue from statutes of regulated provinces
  - Certain aspects of DD to be amended
- Avoid misrepresentations
- Don't provide certificate of disclosure
- Obtain receipt



## #5: Obtain Management Buy-in

- Critical to ensure:
  - Commitment to proper disclosure practices
  - Control over process



## #6: Assign Responsibility to Key Personnel

- Coordinate the disclosure process
- Collect and collate information
- Review and approve its accuracy
- Ensure that the DD is continuously up-to-date
- Manage in-house salespersons & outside brokers
- Ensure that there are no delays

...

...





## #7 - Signatories to Certificate of Disclosure

- Ensure that at least:
  - One officer and director
  - Two officers
  - Two directors,
- Reviews, signs and dates the DD



## #8 - Receipts

- Collect a signed and dated receipt
- Consider impact of *MAA Diners* decision



## #9 - Consistency

- Ensure consistency:
  - Within Disclosure Document
  - With Franchise Agreement
  - With Website
  - With Marketing Materials



## #10 - Confidentiality and Privacy Issues

- Address confidentiality and privacy issues



## Safekeeping

- #11 - Serialize each Disclosure Document issued
- #12 - File each Disclosure Document issued for safe-keeping

## #13 - Proper Form of Financial Statements



- Opening Balance Sheet
- Review Engagement
- Audited
- Financial disclosure exemption available?



## #14 – Timeliness of Financial Statements

- “If 180 days have not yet passed since the end of the most recently completed fiscal year and a financial statement has not been prepared and reported for that year, the disclosure document shall include a financial statement for the previous fiscal year”



## #15 - Coordination with Accountants

- Coordinate preparation of financials with accountants
  - To ensure that disclosure process is not delayed





## #16 – Consistency with Financial Statements

- Ensure consistency of Disclosure Document with Financial Statements
  - Notes to financials
  - Marketing fund contributions
  - References to Litigation
  - Other



## #17 - Checklist

- Create checklist of items to be regularly updated
  - To facilitate speed and ease of updating disclosure document



## #18 - 14-Day Rule

- Ensure that no agreements signed or monies received within 14 day period



## #19 – Calculation of 14 Day Period

- Each jurisdiction excludes the day on which the DD is received, but:
  - Ontario & NB - includes the day on which a FA is signed or payment is made to the franchisor
  - Alberta, PEI & Manitoba- excludes the day on which the FA is signed or payment is made to the franchisor



## #20: As “one document and at one time”

- *Dig This Garden* (Ontario Court of Appeal)
  - Not an empty, formal requirement
  - “The language of the Act is unambiguous, and it is mandatory”
  - “People have more difficulty processing and assessing information given at different times, some of it orally, than they do information provided in a single, written document”



## #20: As “one document and at one time”

- All peripheral documents
  - Any financial representations?
  - Marketing brochures, napkins?!
  
- Manitoba proposed Section 5(3):
  - “If the disclosure document is not delivered as one document, the requirement under subsection (2) is not met until the date of the delivery of the last Document.”



## #21- Delivery of DD to all Relevant Parties

- Guarantors
- Spouses
- Corporate affiliated entities
- Others?



## #22- Electronic Delivery?

- Ontario, Alberta, New Brunswick
  - Personal delivery & registered mail
- Prince Edward Island
  - Courier & electronic delivery
- Manitoba
  - Personal delivery & registered mail (or any other prescribed method)





## #23 - Balancing Competing Statutory Obligations

- Balancing the:
  - “Accurate, clear & concise rule” with
  - “When in doubt disclose”



## #24 - Definition of “Material Fact”

- Ontario
- In other jurisdictions
- Other “material facts” (Ontario)



## #25 - Definition of “Material Change”

- “Significant adverse effect” versus “significant effect” on:
  - The value or price of the franchise to be granted; or
  - The decision to acquire the franchise



## #26 - When is a MCS Appropriately Used?

- To amend errors in previous disclosures?
- Or to address any “material adverse changes”?



## #27 - Form of Material Change Statement

- Similar to form of Disclosure Document
- Certificate
- Receipt



## #28 - Timing re Issuing a MCS

- “As soon as practicable after the change has occurred” and before:
  - Agreement signed; or
  - Payment made



## #29: Better Late than Never: Rectifying Deficient Disclosure

- *Invescor Restaurants Inc.*
  - Franchisor failed to provide franchisee with a DD within the requisite 14-day period
  - Ont C.A.: Franchisee could only rely on s.6(1)
  - Late disclosure, therefore, could effectively knock out the 2-yr right of rescission
- Provide full refund, re-disclose and obtain release?



## #30: When is a DD not a DD?

- *Dollar It* (2009 Ont. C.A.)
  - S.6(2) 2-yr right of rescission (not as trial court found, i.e., s.6(1) 60 day right of rescission)
  - Lack of certificate alone deemed fatal - as per Hi Hotels case (discussed later)
  - Head lease should have been disclosed along with details regarding the landlord





## #30: When is a DD not a DD?

- *Sovereignty* (2008 Ont Superior Ct of Justice)
  - 4 deficiencies sufficiently material, each fatal on its own
  - Balance of minor deficiencies not sufficiently material
  - A # of minor deficiencies cannot, on a cumulative basis, disqualify documentation as a “DD”



## #31: Post-disclosure Disclosure

- Definition of “franchise agreement”



## #32: Customizing the DD

- Renewal
- Transfer
- Resale
- Any other special circumstances?



## #33: Certificate of Disclosure

- Ensure reviewed, signed and dated:
  - By appropriate executive(s)
  - Two directors and/or officers rule
  - Date important as tied to several disclosures
  - Statutory exposure against “every person who signed the certificate”
  - Not a mere formality – it is in the statute stupid!



## #33: Certificate of Disclosure

- *Hi Hotel (Alberta C.A.)*
  - Undated and unexecuted cert – fatal
  - Not merely form or a technicality as “it’s the linchpin of the substance of the disclosure”
  - No “substantially complete” defence was available



## #33: Certificate of Disclosure

- Important for 2 reasons:
  - Production of signed and dated Certificate is a substantive requirement of the DD
  - If the DD contains any material inaccuracies, the franchisee has two individuals to sue
- *Dollar It (Ont C.A.)* – as noted earlier



## #34: Work with Professionals & Suppliers to Ensure Compliance

- Internal sales department and franchise brokers
- Legal counsel
- Accountants
- Suppliers such as website portals
- Area developers, master franchisees, area representatives



# Conclusion

- Carefully review legislation
- Assign responsibility to key personnel
- Systemize procedures
- Customize, customize, customize
- Avoid potential liability
- Encourage more informed franchisees
- Solicit professional advice





# Contact Me

- [www.hofferadler.com](http://www.hofferadler.com)
- [jadler@hofferadler.com](mailto:jadler@hofferadler.com)
- 416-977-3444

These slides do not constitute legal advice