Ontario Bar Association Article – Business Beat – Winter 2009

Important Developments in Franchise Disclosure Law: When is a disclosure document not a disclosure document?

By Joseph Adler and Cynthia Yang

Franchise legislation in each of the provinces of Ontario, Alberta and PEI require franchisors to provide prospective franchisees with a disclosure document which contain information material to the business and the franchisor's franchise system as well as other information required by regulations. The purpose of this legislation is to provide a prospective franchisee with sufficient information to assess the value and price of the franchise under consideration and so that he or she can make an informed decision as to whether to purchase the franchise. In the case of the Province of Ontario, the statutorily delineated items of information that must be disclosed are set out in the *Arthur Wishart Act (Franchise Disclosure), 2000*[1] (the "Ontario Act") and its Regulations.[2]

Where a franchisor fails to comply with the disclosure requirements of the Ontario Act, a franchisee has a statutory right to rescind the franchise agreement and to recover moneys paid to the franchisor as well as any losses incurred in relation to its investment in the franchise. In practice however, a franchisee's right of rescission is not as clear as one may think, because the Ontario Act provides for different and somewhat conflicting periods for invoking the rescission remedy. If a franchisor fails to provide a disclosure document or a statement of material change within the applicable time requirements, or if a disclosure document did not meet the content requirements of the Ontario Act, a franchisee may rescind the franchise agreement up to 60 days after receiving the disclosure document (s.6(1)). If a franchisor fails to provide a disclosure document at all, however, the rescission period is extended to 2 years after entering into the franchise agreement (s.6(2)).

Due to the significant difference of time between the two possible rescission periods, a hot issue in franchise litigation is when is a disclosure document so materially deficient that it is considered a nullity (i.e., does not constitute a disclosure document at all), thus giving the franchisee 2 years to rescind? The following recent decisions shed some light on this pressing issue.

Sovereignty Investment Holdings Inc. v. 9155-6498 Quebec Inc.[3]

The franchisee in this case received from the franchisor, at different times, a sales package, a purported disclosure document, *pro forma* financial projections, a *pro forma* opening balance sheet, a store development financial model, various lease documents, and a draft franchise agreement. The franchisee later sought rescission as well as recovery of the purchase price and damages.

The court held that there were at least 4 deficiencies to the disclosure document, each of which alone would have been sufficient for the court to rule that the franchisor failed to deliver a disclosure document, thereby giving the franchisee 2 years to rescind. The deficiencies included the franchisor's failure to: 1) include financial statements; 2) provide any basis or assumptions for the earnings projections; 3) deliver the disclosure document as a single document and at one time; and 4) include a certificate of disclosure of the franchisor.

---

[1] S.O. 2000, c.3.
[2] O.Reg. 581/00.
[3] 2008 CarswellOnt 6547

In its decision, the court ruled that the 60 day rescission period is appropriate where the disclosure does not allow a franchisee to make a *fully informed decision*. In contrast, the 2 year period would be appropriate where the disclosure is so deficient such that a franchisee is unable to make *an informed decision at all*. Of note, the court held that a number of minor deficiencies in the disclosure document alone could not cumulatively "disqualify" documentation as a disclosure document, thereby making it void.

***Hi Hotel Limited Partnership v. Holiday Hospitality Franchising Inc.*[4]**

Though this decision of the Alberta Court of Appeal does not have direct application to franchisors doing business in Ontario, it may foreshadow a similar approach to disclosure law by the Ontario courts.

The parties in this case entered into a franchise agreement, and while the franchisor provided the franchisee with a disclosure document, there were no certificates of disclosure which were signed and dated. The relationship deteriorated over the course of a year, and the franchisee sought to rescind the agreement. The court held that properly executed certificates are mandatory pursuant to Alberta's *Franchises Act*[5], and that the absence of both signatures and dates on the certificates is a fatal error that amounts to no disclosure being given at all.

Although Alberta legislation provides that a disclosure document is properly given if it is "substantially complete", the court held that a certificate without both signatures and a date cannot amount to substantial compliance. The court however noted that the absence of a date alone, or an erroneous or incomplete date on a signed certificated may not be fatal.

The Ontario Act does not prescribe a "substantial compliance" test, opting instead for a standard of "non-compliance". Arguably, this is a more stringent standard, and it follows that where disclosure is not substantially compliant, it cannot satisfy the Ontario Act's requirements. As such, if subsequent Ontario courts adopt the approach of this decision, then a certificate that is not signed and dated would amount to no disclosure, giving the franchisee 2 years to rescind.

***6862829 Canada Ltd. et al v. Dollar It Limited et al*[6]**

This is an application brought by the franchisee, seeking to rescind a franchise agreement under s.6(2) on the grounds that the disclosure document was so deficient that it constituted no disclosure. It is important to note that unlike previous cases, the procedural requirements relating to delivery were met in this instance. That is, the disclosure document was delivered within the prescribed time period, as one document and at one time. The main issue was whether a disclosure document could be disqualified based on deficiencies in content alone.

After reviewing the relevant case law, the court held that even if a disclosure document is delivered in accordance with the Ontario Act, where it lacks information material to the franchise, then the disclosure document may be considered a nullity, constituting no disclosure at all. In coming to this conclusion, the court placed much emphasis on the Ontario Act's objective to protect the interests of franchisees through rigorous disclosure requirements. Since the franchisor has sole access to most information regarding the franchised business, there is a significantly heavy onus on the franchisor to determine what information is "material" and to provide such information to the franchisee. Where the franchisor fails in discharging this onus, strict penalties of the Ontario Act should be applied according to the court.

---

[4] [2008] A.J. No. 892
[5] R.S.A. 2000, c. F-23
[6] Court File No.: 08-CV-41479, Date: 2008/11/20

On the facts, the following were cited by the court to be material deficiencies: 1) the absence of financial statements; 2) the absence of a certificate duly completed and signed; 3) the absence of notice of a pending lawsuit against the franchisor by one of its franchisees; 4) the absence of a copy of the existing offer to lease; and 5) the lawyer identified by the disclosure documents to receive service of process was not in fact authorized to do so. It was unclear whether the court felt that each or any of these deficiencies alone were enough to disqualify the disclosure document, or whether it was the cumulative effect of the deficiencies that brought the disclosure document into s.6(2). On the one hand, the court pointed out that its decision was partly based on "the number of deficiencies". On the other hand, the court drew attention to the lack of certificate, and stated that the presence of a certificate is of "particular importance and substance". Whatever the case may be, it is clear that this court is advising franchisors to be especially diligent in their preparation of their disclosure documents in order to avoid severe rescission penalties.

Interestingly, the identical disclosure document was at issue in a separate application where another franchisee sought the same relief against the franchisor, and based their arguments on identical contractual documents.[7] The court in that application came to the opposite conclusion and held that when considered as a whole, the disclosure document was in fact compliant with the requirements of the Ontario Act. Further, the court held that even if that were not the case, the want of compliance would not void the disclosure document *ab initio*. An appeal for the application has been perfected, and a hearing is pending.

Conclusion

The courts have, in the short time of a few years, considerably augmented the burden on franchisors to comply fully with both the procedural and substantive requirements of the Ontario Act. Until recently, the majority of cases where the s.6(2) remedy was applied primarily involved instances where the disclosure documents did not meet certain procedural requirements. i.e., they were not delivered as one document and at one time. Although deficiencies in content were also germane to the result, the decisions seemed to turn on whether the disclosure documents complied with the formal requirements of the Ontario Act.[8] With the decisions of *Sovereignty* and *Dollar It*, however, the focus seems to have now shifted to whether there was disclosure of *all* material information. Taken together, the two decisions imply that even if a disclosure document complies with all the formal requirements, it may be deemed to be no disclosure at all if even one single piece of material information is missing. However, the courts have not to date provided a clear definition of what constitutes "material information" beyond what is prescribed by the Ontario Act and Regulations. Franchise counsel will certainly benefit from additional guidance from the courts in this regard. As the law currently stands in Ontario, however, the need for franchisors to be fully comprehensive and diligent in their preparation of disclosure documents is more critical than ever.

* *Joseph Adler, Partner, Hoffer Adler LLP, (416) 977-3444 and Cynthia Yang, Articling Student, Hoffer Adler LLP.*

[7] *6792341 Canada Inc. et al v. Dollar It Limited et al.* Court File No.: 08-CV-40893, Date: 2008/06/18

[8] See for example *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd* 2005 CarswellOnt 3097, and *1518628 Ontario Inc. v Tutor Time Learning Centres LLC.* 2006 CarswellOnt 4593.