

## Franchise Disclosure: To be or not to be, that is the question The Sequel...

On the heels of the recent decision in *Sovereignty Investment Holdings Inc. v. 9127-6907 Quebec Inc.*<sup>1</sup>, the Ontario Superior Court of Justice has released its decision in *6862829 Canada Limited v. Dollar It Limited*<sup>2</sup>, which appears to have expanded the list of disclosure document deficiencies that would be fatal to a franchisor's compliance with the disclosure obligations under the *Arthur Wishart Act (Franchise Disclosure), 2000* (the "Act").

Given that the consequences of failing to meet these disclosure obligations provided the franchisee with a statutory rescission right and reimbursement of all amounts paid or incurred to set-up or acquire the franchise, the franchisors in both of these cases strenuously defended the actions by primarily focussing upon the limitation periods in which the franchisee ought to have exercised its notice of rescission. Section 6(1) of the *Act* provides that if a disclosure document is delivered late or is deficient in content, the franchisee has 60 days after receiving the disclosure document in which to rescind the agreement and obtain reimbursement of all amounts paid to the franchisor or otherwise incurred to set up or acquire the franchise. However, section 6(2) goes on to state that if a disclosure document was never provided, the limitation period for rescission by the franchisee is extended to 2 years after signing of the franchise agreement.

As stated by Justice Wilton-Siegal in *Sovereignty Investment*:

Section 6(1) is directed to the situation in which the franchisee was unable to make a fully informed decision as a result of inadequate time for consideration of such decision or inadequate disclosure of the material facts. Section 6(2) is directed to the situation in which the franchisee is unable to make an informed decision at all because of fundamental deficiencies in the disclosure provided to it. There may be circumstances in which the dividing line is hard to draw. Indeed, whether such a distinction is practicable in the context of franchising practice, as compared with the practice in respect of the distribution of securities, which appears to be the model for this statutory approach, may be questioned but is beyond the role of the Court. However, this is not a situation in which there is any difficulty drawing the dividing line.

In *Dollar It*, the franchisee received a disclosure document and, more than 14 days later, paid certain amounts to the franchisor and signed a franchise agreement. As in *Sovereignty Investment*, the disclosure document delivered to the franchisee did not comply with the requirements of the *Act*. The franchisee delivered a notice of rescission to the franchisor after the 60-day period from the date of receipt of disclosure but well within the two-year period after the franchise agreement was signed. The question turned on whether the franchisee had the right to rescind the franchise agreement within the 60-day period or within the two-year period.

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<sup>1</sup> 2008 CanLII 57450 (Ont. S.C.) – Released November 7, 2008 ("*Sovereignty Investment*").

<sup>2</sup> 2008 CanLII 60699 (Ont. S.C.) – Released November 20, 2008 ("*Dollar It*").

In interpreting the *Act*, Justice Linhares de Sousa reviewed the legislation's statutory intent which was to protect franchisees, and to meet this intent, franchisors were required to comply with rigorous requirements of providing accurate and complete disclosure containing all material facts. The judge found that, although disclosure was given within the correct time frame and in one document, the disclosure document lacked the following material information:

- financial statements or a balance sheet as required by the *Act*;
- a completed certificate signed by the franchisor and at least one of its directors;
- notice of a pending law suit against the franchisor by one of its franchisees;
- a copy of the existing offer to lease for the franchised premises; and
- correct information about whether the lawyer stipulated in the disclosure document was authorized to receive service of process in Canada on the franchisor's behalf.

The Court determined that the absence of the above information resulted in such materially deficiencies that the document completely failed to meet the disclosure obligations under the *Act*. As such, the franchisee's rescission notice was validly delivered within the 2-year limitation period.

In *Sovereignty Investment*, the Court clearly stated that each deficiency on its own was sufficient to disqualify the disclosure document. Although the decision in *Dollar It* did not specifically address this point, since both cases cited similar and overlapping deficiencies, it may be logically inferred that each of the deficiencies in this case are also independently fatal.

To summarize and combining the decisions in *Sovereignty Investment* and *Dollar It*, each of the following deficiencies on its own will be considered fatal to any disclosure document delivered by a franchisor:

- The failure of the franchisor to include a copy of its financial statements or an opening balance sheet with disclosure as required by the *Act* and the regulations.
- The failure of the franchisor to include a statement specifying the basis for the earnings projections and estimates, as well as a statement of assumptions underlying the estimates and a location where information was available for inspection to substantiate such estimates and projections.
- The failure of the franchisor to provide disclosure in a single document and delivered at the same time.
- The failure of the franchisor to include a signed Certificate of Disclosure confirming that disclosure was true and accurate and contained all material facts.
- The failure of the franchisor to disclose details of any ongoing or pending lawsuit against it for fraud, unfair business practices, or a violation of any franchise or business laws.
- The failure of the franchisor to provide a copy of an offer to lease or lease, whichever is applicable, for the proposed franchised premises.

- The failure of the franchisor to properly identify the person authorized to accept service in Ontario on behalf of the franchisor.

It is also worth noting that the decision in *Dollar It* was released after a decision of Justice McLean on another application with identical facts brought against the same franchisor by a different franchisee.<sup>3</sup> In that other case, Justice McLean reached the opposite conclusion that the rescission period was limited to 60 days because, in considering the matter as a whole, the document was compliant. It appears that Justice McLean strongly emphasized and relied on jurisprudence that deemed disclosure that is not made in a single document to be no disclosure.<sup>4</sup> Justice McLean's decision is currently being appealed, and hopefully the Ontario Court of Appeal will provide us with some clearer guidance on which of these conflicting approaches should be taken.

In the meantime, franchisors should be abundantly cautious to ensure that their disclosure documents comply with the *Act* and its regulations, paying particular attention to the above noted deficiencies that could leave them open to a claim of rescission for a period of up to two years after signing the franchise agreement.

**For more information on franchising contact Derwin Wong or Dixie Ho at Morrison Brown Sosnovitch LLP, 1 Toronto Street, Suite 910, Toronto, ON M5C 2V6, Phone: (416) 368-0600 Fax: (416) 368-6068 email: [dwong@businesslawyers.com](mailto:dwong@businesslawyers.com) or [dho@businesslawyers.com](mailto:dho@businesslawyers.com).**

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<sup>3</sup> 6792341 *Canada Inc. c. Dollar It Limited*, (unreported) – Released June 18, 2008

<sup>4</sup> 1490664 *Ontario Ltd. V. Dig this Garden Retailers Ltd.* (2005), 201 O.A.C. 95; 1518628 *Ontario Inc. v. Tutor Time Learning Centres LLC*, 2006 CarswellOnt 4593; *MAA Diners Inc. v. 3 for 1 Pizza & Wings (Canada) Inc.*, 2003 CarswellOnt 455.