
WAKE FOREST JOURNAL OF BUSINESS
AND INTELLECTUAL PROPERTY LAW

VOLUME 14

SUMMER 2014

NUMBER 4

**FRANCHISE DISCLOSURE IN CANADA: HOW FRANCHISE
LEGISLATION PROTECTS FRANCHISEES' RIGHTS IN THE
CONTEXT OF FRANCHISORS' DUTY OF DISCLOSURE**

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I. INTRODUCTION

Franchise law is a growing area in the Canadian marketplace, and the legal issue of franchise disclosure is becoming prominent in the context of the franchisor-franchisee business relationship. Franchise disclosure is a request by a franchisee investor to the franchisor to provide detailed background documents about the franchise.¹ This disclosure is meant to provide accurate, timely, and verified information to enable a prospective franchisee investor to make informed decisions about investing in the franchise, while also ensuring that the franchisor is both accountable and transparent about his business to the franchisee.² In Canada, franchise legislation prescribes specific technical criteria regarding what constitutes “adequate disclosure” on the part of the franchisor.³ There are five provinces with franchise legislation: Alberta, Ontario, Prince Edward Island, New Brunswick, and Manitoba.⁴ More specifically, the rule is that franchise disclosure must have form and content with sufficient particularity.⁵ If franchise disclosure documents are given to a franchisee following this legislative criteria, then a franchisor has fulfilled adequate disclosure.⁶ If not, a franchisee has a statutory right to seek a claim of rescission and damages with respect to the alleged inadequate disclosure or non-disclosure relating to the franchised business.⁷ Thus, franchise legislation adds a layer of legal protection which favors the franchisee, in a relationship often dominated by one-sided franchise agreements where, in many instances, the franchisee holds an unequal bargaining position with a franchisor offering its established business model.

The purpose of this paper is to review case law that describes how franchise legislation in Canada protects franchisees' rights with respect to a franchisor's duty of disclosure, particularly when franchisees experience financial losses in the operation of the franchise. This paper argues that Canadian courts strictly enforce franchise disclosure provisions against franchisors, and in this way are protecting franchisees' rights with respect to disclosure when experiencing

¹ See Fraser Milner Casgrain LLP, ASS'N OF CORPORATE COUNSEL, FRANCHISING LEGISLATION IN CANADA (2009), available at <http://www.acc.com/legalresources/quickcounsel/flic.cfm>.

² See *id.*

³ *Doing Business in Canada: Franchise Law*, GOWLINGS, <http://www.gowlings.com/services/dbic/?p=18> (last visited May 28, 2014).

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

primarily financial losses in the franchised business. This enforcement complies with the legislative intent of requiring adequate disclosure to provide accurate, updated, verified, and comprehensive disclosure documents to prospective franchisees so that they can make reasonably informed decisions about investing in the franchise, thereby creating a more stable franchisor-franchisee relationship.⁸

Part II of the paper introduces the basic concept of franchise law, as well as the current franchise legislation in Canada that outlines the ground rules of what constitutes adequate franchise disclosure. Part III describes key provisions in Canadian franchise legislation that are routinely applied by courts when interpreting such provisions in legal disputes between franchisees and franchisors. Part IV focuses on modern Canadian case law and how courts apply such franchise provisions in various circumstances. By examining franchise case law, one can appreciate the author's position that franchise legislation protects franchisees from being given disclosure documents that may be incomplete, untimely, and often misleading, thereby preventing one from making an uninformed decision to invest and operate a franchise.

II. FRANCHISE LAW—WHAT IS IT?

A franchise is a business relationship between a franchisor and a franchisee, where the franchisor has an established business model within a particular industry, and offers an opportunity to purchase and operate this business to prospective investors (franchisees) for profit. The franchisee is an investor who normally meets a franchisor representative at a trade show, or responds to an advertisement posted by the franchisor.⁹ Alberta's *Franchises Act* defines a franchise as

[A] right to engage in a business in which goods and services are sold or distributed under a marketing or business plan prescribed mostly by the franchisor or its associate, that is substantially associated with a trademark . . . and that involves a continuing financial obligation to the franchisor . . . by the franchisee and significant continuing operational controls by the franchisor . . .¹⁰

There are several types of franchised businesses (such as fast-food restaurants, convenience stores, and mechanic shops), and this

⁸ See *id.* (explaining the reasoning behind the remedies implemented by franchise legislation).

⁹ See generally *Franchises Act*, R.S.A. 2000, c F-23 (Can.) (defining franchisee and franchisor).

¹⁰ *Id.*

commercial relationship becomes part of a broader “franchise system” that is dominated by various legal elements, including:

- agreements (examples include franchise agreements, lease and subleases, purchase and sale agreements)
 - set obligations of franchisors and franchisees
- franchise disclosure documents
 - franchise marketing and business plans
 - financial statements
 - location(s)
 - uses of a franchise's trademark, trade name, advertising, and goodwill¹¹

A. The Franchise Model

Initially, preliminary information is given to the franchisee (normally as an informational circular), and later, when the franchisee has made a serious commitment to purchase the right to operate a franchise, the franchisee will request franchise disclosure documents under the franchise model.¹² The franchise model is the business and marketing plans of the franchise, and is presented to prospective franchisees in order to attract their investment.¹³ The franchise model is essentially a guide for how the franchisee can make a profit, using the franchise's advertising, goods and services, inventory, and known distribution of suppliers. However, the franchise model is able to best serve the franchisee when the franchisee has had an opportunity to investigate the franchise disclosure documents that provide the overall background of the franchise system. Upon an agreement to invest, a franchisee pays the franchise fee to purchase its right to operate the business.¹⁴

The relative success of the franchise model depends on a franchisee's reliance on the franchise disclosure documents that

¹¹ See *id.*

¹² See *Doing Business in Canada*, *supra* note 3 (discussing the protection disclosure documents offer under the franchise system); see also Franchises Act, R.S.A. 2000, c F-23 (Can.) (defining business plan, which specifies how a business must be conducted under the Act).

¹³ See generally Dennis L. Monroe, *Sales Tactics*, FRANCHISE TIMES (Oct. 2012), <http://www.franchisetimes.com/October-2012/Sales-Tactics/> (providing the strategy about how to attract franchisees, an example of “franchise model” as defined).

¹⁴ See *Doing Business in Canada*, *supra* note 3.

outline how a person can achieve success with that franchise. This is why disclosure document provisions were introduced under the rubric of franchise legislation – a legal requirement that must be fulfilled by a franchisor to provide “material facts” to a prospective franchisee.¹⁵ Material facts include all relevant information about the franchise business, including its operations, capital, degree of franchisor control, and other aspects of the franchise system, all of which may ultimately convince a prospective franchisee to invest in the franchise.¹⁶

B. Franchise Legislation in Canada

Franchise legislation consists of various provisions and regulations in governing jurisdictions. In Canada, it is a series of provincial laws because Section 92(13) of the Constitution Act of 1867 grants exclusive power to provinces over “property and civil rights.”¹⁷ Franchise legislation describes the legal terms, principles and procedures for the franchisor and franchisee, while franchise regulations serve as an enforcement tool of the statute. Some regulations govern taxes, packaging and labeling, privacy, foreign investment, intellectual property (such as trademarks), and competition law. Currently, five jurisdictions in Canada have franchise legislation – Alberta, Ontario, New Brunswick, Prince Edward Island, and Manitoba.¹⁸ The first jurisdiction to adopt franchise legislation was Alberta in 1972 via the enactment of its *Franchises Act*.¹⁹ The second province was Prince Edward Island with its own *Franchises Act* in 1988.²⁰ Ontario became the third province in Canada to introduce franchise law with its *Arthur Wishart Act (Franchise Disclosure)*²¹ in 2000, and the fourth province was New Brunswick, which also introduced its own *Franchises Act*²² in

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Constitution Act, 1867 § 92(13), 30 & 31 Vict., 3 (U.K.), reprinted in R.S.C. 1985, app. II, no. 5 (Can.).

¹⁸ *Franchise Legislation*, CFA, <http://www.cfa.ca/advocacy/franchise-legislation/> (last visited May 18, 2014) (listing the Canadian provinces having franchise legislation).

¹⁹ Dominic Mochrie & Frank Zaid, *Something Old, Something New: A Comparison of Canada's Newest Franchise Legislation Against Existing Franchise Laws*, 6 UNDERNEATH THE GOLDEN BOY 403, 403 (2009).

²⁰ LEGISLATIVE COUNSEL OFFICE, GOV'T OF PRINCE EDWARD ISLAND, UNOFFICIAL TABLE OF PUBLIC ACTS 36 (Feb. 2014), available at http://www.gov.pe.ca/photos/original/leg_table_acts.pdf.

²¹ See Mochrie & Zaid, *supra* note 19.

²² Franchises Act, S.N.B. 2007, c. F-23.5 (Can.) (providing the assented date).

2007. The most recent franchise legislation was introduced by Manitoba in 2012 with its *The Franchises Act*.²³

Disclosure documents prepared by a franchisor in a province with franchise legislation can be used in other provinces without formal franchise legislation. In this situation, a franchisor would typically prepares a “wrap-around” document that can be forwarded to the franchisee.²⁴ Perfect disclosure is not a legal requirement—technical irregularities in a franchisor’s disclosure documents are allowed under franchise legislation. Rather, a franchisor must give “substantial compliance” with disclosure requirements.²⁵

One major purpose of franchise legislation is to protect the franchisee when a franchisor provides little or no information relevant to the franchised business. If there is a breach of disclosure provisions, the disclosure legislation gives the franchisee the right to seek rescission and damages against the franchisor.²⁶ Adequate disclosure and statutory remedies are outlined in section 2 of Alberta’s *Franchises Act*, which indicates three purposes:

- (1) assists prospective franchisees in making informed investment decisions by requiring the timely disclosure;
- (2) provide civil remedies dealing with breaches; and
- (3) to guide franchisors and franchisees to govern themselves and promote fair dealing among themselves.²⁷

The statutory language implies that franchisees can make an informed decision to invest in a franchise. If a franchisor breaches its duty to provide adequate disclosure documents to a franchisee, a franchisee can seek legal remedies as rescission and damages under the remedial portions of franchise legislation. In principle, the law expects that there be fair dealing between a franchisor and franchisee. With respect to adequate disclosure, current franchise legislation in Canada requires four major things:

- adequate disclosure in one document, including key documents such as:

²³ Franchises Act, C.C.S.M. 2012, c. F-156 (Can.) (providing the effective date).

²⁴ See *Franchising Legislation in Canada*, ACC (Dec. 2, 2009), <http://www.acc.com/legalresources/quickcounsel/flic.cfm>.

²⁵ Franchises Act, C.C.S.M. (2013), c. F-156, § 5(10) (Can.).

²⁶ *Id.* §§ 6(1), 7(1).

²⁷ Franchises Act, R.S.A. 2000, c. F-23, § 2 (Can.).

- franchise agreements
- financial statements
- other agreements (including leases, subleases, purchase and sale agreements);
- timely delivery of disclosure (within fourteen days prior to signing any agreement);
- delivery of documents personally, by registered mail, or “any other prescribed method,” such as fax, courier, or electronic means; and
- provision of “material facts” about the franchise.²⁸

Additional obligations under franchise legislation include timely disclosure, notice of material change, and financial statements. First, a franchisor is required to deliver disclosure documents “at least 14 days” before the signing of any agreement or payment of consideration by the prospective franchisee.²⁹ This gives time for the franchisee to absorb the materials at hand and determine whether it is in his best interests to pursue the franchise opportunity. Second, franchisors are expected to give notice of any “material change” in its disclosure, which includes any change in the business, operations, capital, franchise system, or degree of franchisor control, all of which must be communicated to the franchisee as soon as practicable after the change has occurred.³⁰ Material change, of course, relates to “material facts.” The assumption is that in order for a franchisee to make an informed investment decision, he must rely upon the most updated information that reflects the business direction and potential of the franchise. Is the franchise expanding to other cities, or is it experiencing financial losses?

Third, a franchisor is required to provide financial statements (balance sheets, income statements, statement of retained earnings, and statement of cash flows), for the most recently completed fiscal year, along with audited financial statements, both of which must be prepared in accordance with generally accepted auditing standards or generally accepted accounting principles equivalent to the *Canadian Institute of Chartered Accountants Handbook*.³¹ A financial statement for the previous fiscal year may be submitted by a franchisor, provided that 180 days have not passed since the end of the most recent fiscal

²⁸ See, e.g., Franchises Act, R.S.M., 2010, c. F-156, § 5 (Can.).

²⁹ Franchises Act, R.S.A. 2000, c. F-23, § 4(2) (Can.).

³⁰ *Id.* at § 4.

³¹ See Franchises Regulation, Alta. Reg. 240/1995, § 3 (Can.).

year.³² Exemptions to the financial statement disclosure rule occur where a franchisor self-assesses itself, its recent net worth is at least C\$5 million, it has continuously engaged in the franchise business for at least five years, has at least twenty five franchisees, and has had no lawsuits against it for the last five years.³³

III. FRANCHISE DISCLOSURE CASE LAW IN CANADA

Canadian jurisprudence has case law relating to disclosure requirements under franchise legislation, and how courts interpret such provisions to protect franchisees' rights.³⁴ Typically, legal disputes arise when a franchisee experiences financial losses after signing a franchise agreement with a franchisor.³⁵ In that scenario, the franchisee files suit against the franchisor on the basis of receiving inadequate disclosure which prevented the franchisee from making informed investment decisions about the franchise.³⁶ As will be shown, remedial provisions of franchise legislation allow a franchisee to seek rescission of a franchise agreement (and other compensatory and punitive damages) by serving the franchisor with a "notice of

³² *Id.* at § 3(5).

³³ Arthur Wishart Act, O. Reg. 581/00, § 11 (Can.). Realize that there are exemptions to the franchise disclosure documents. All of these exemptions are found under section 5(7) of Ontario's *Arthur Wishart Act*. Statutory exemptions exist for franchise disclosure documents. The first exemption relates to an executor (person appointed in a will), administrator, trustee, sheriff receiver, or guardian is not required to provide disclosure documents with a grant of a franchise. A second exemption is where there is a grant of franchise by a franchisee who is not the franchisor, the grant of the franchise is for the franchisee's own account, and the grant of the franchise is not effected through the franchisor. A third exemption is for a grant of a franchise to a person to sell goods or services within a business, as long as the sales arising out of that business do not exceed twenty percent of the total sales of the business. A fourth exemption is where there is a grant of franchise to a prospective franchisee who is investing over \$5 million in one year in the purchase and operation of the franchise (known as the sophisticated franchisee exemption). A fifth exemption is where there is a grant of franchise, but the prospective franchisee makes a total annual investment to buy and operate the franchise not exceeding \$5,000.00, the franchise agreement is valid for one year or less (for a short-term franchisee), or the franchisor is governed by section 55 of the federal *Competition Act*. A sixth exemption is where there is a renewal or extension of a franchise agreement, and where there has been no interruption of the business operations by the franchisee, and no material change since the franchise agreement was signed. The burden of proof lies with the franchisor claiming such disclosure exemptions.

³⁴ See George J. Eydt & Edward (Ned) Levitt, *The Devil is in the Details: How Canadian and U.S. Franchise Legislation Differs*, 32 FRANCHISE L.J. (SPRING) 237, 237–238 (2013).

³⁵ *Id.*

³⁶ See, e.g., Arthur Wishart Act (Franchise Disclosure), O. Reg. 581/00 §§ 6–7 (Can.).

rescission.” The basis of the rescission claim is that the franchisor gave inadequate disclosure, which lacked *form* and *content*.³⁷ *Form* refers to the nature of documents that are delivered to the franchisee, including whether disclosure draft documents or originally executed documents were verified by franchise representatives.³⁸ *Content* refers to pertinent information (including terms and conditions, financial statements, and location) relied upon by a franchisee which substantially reveal the true nature of the franchise business, and help make an informed investment decision in the franchise.³⁹ In the following case law, one can appreciate how the technical nature of the disclosure requirements plays a large role in protecting franchisees’ claims against franchisors.

A. Inadequate Disclosure

In 2005, *Walden v. 887985 Alberta Ltd.*⁴⁰ saw the Ontario Superior Court of Justice consider the issue of whether a franchisor failed to provide adequate franchise disclosure documents to the franchisee. In this matter, the franchisee, Walden, entered into a franchise agreement with the franchisor, AG Connexions, a franchise business which operated a purchasing network for member farmers who could then purchase agricultural products for discounts or benefits.⁴¹ The franchisor sold rights to dealerships within a specific geographical region of Canada that allowed franchisees to sign up customers in the agricultural community.⁴² Franchisees would then be compensated for the memberships they attracted to the franchise business.⁴³ The franchisor was incorporated in Alberta⁴⁴, but in this case was offering a franchise opportunity in the region around Blyth, Ontario.⁴⁵ The franchisee responded, met with the franchisor, and later received a brochure and a draft franchise agreement.⁴⁶ The franchisee made a partial payment of C\$45,000.00 for the franchise fee, and attended a

³⁷ *Id.*

³⁸ *Franchise Acts and Regulations*, UNIFORM LAW CONFERENCE OF CANADA, <http://ulcc.ca/en/home-en-gb-1/403-josetta-1-en-gb/uniform-actsa/franchises-act/1126-franchises-act-and-regulations?showall=&start=8> (last visited May 28, 2014).

³⁹ Arthur Wishart Act (Franchise Disclosure), O. Reg. 581/00 (Can.).

⁴⁰ *Walden v. 887985 Alberta Ltd.*, 2005 CanLII 1503 (ON SC).

⁴¹ *Id.* at paras. 3–37.

⁴² *Id.* at paras. 5–6.

⁴³ *Id.* at para. 6.

⁴⁴ *Id.* at para. 3.

⁴⁵ *Id.*

⁴⁶ *Id.* at paras. 8–9.

training seminar offered by AG Connexions.⁴⁷ Later, Walden received a disclosure document from the franchisor, along with a “Receipt of Documentation,” which confirmed that the franchisee received the franchise agreement and disclosure document for the purchase of the franchise in Bruce County, Ontario.⁴⁸

Despite the franchisee’s desire to change the territory defined in the franchise agreement to move it closer to his residence, and a second franchise agreement being executed on that basis, Walden did not receive any further disclosure documents, prompting his counsel to send a letter to the franchisor requesting a full refund of the franchise fee of C\$45,000.00 paid to AG Connexions.⁴⁹ The franchisor refused to return his money.⁵⁰ Later, Walden rescinded the second franchise agreement, and claimed damages for C\$46,323.20 (including the franchise fee) under section 6 of Ontario’s *Arthur Wishart Act*.⁵¹ At trial, one of the issues was whether there was proper and adequate disclosure by the franchisor, AG Connexions, to the franchisee, Walden, in compliance with Ontario’s *Arthur Wishart Act*, when the parties entered into agreement to operate the franchise at a different location.⁵² The franchisor filed three exhibits with the court: Exhibit A as the “Franchise Agreement”; Exhibit B as the “Opening Balance Sheet”; and Exhibit C as a “List of Franchisees” (showing territory, residence, and telephone numbers).⁵³ The franchise disclosure document was not signed by the franchisor’s representative, and no financial documents or list of franchisees were attached.⁵⁴ The franchisor argued that the proper disclosure documents were given, and that it was exempt from the disclosure requirement because the second franchise agreement was only an amendment to the first agreement, and there was no material change.⁵⁵

The Ontario Superior Court (trial court) interpreted two sections of Ontario’s *Arthur Wishart Act*⁵⁶—sections 5 and 6. Section 5 of the Act states:

A franchisor shall provide a prospective franchisee

⁴⁷ *Id.* at paras. 12–13.

⁴⁸ *Id.* at para. 27.

⁴⁹ *Id.* at paras. 28–45.

⁵⁰ *Id.* at paras. 43–44.

⁵¹ *Id.* at paras. 45.

⁵² *See id.* at paras. 57–71 (analyzing the issue of whether there was proper disclosure under the *Arthur Wishart Act*).

⁵³ *See id.* at para. 62 (ON SC) (detailing the “Franchise Disclosure Document at Tab 8” which details the contents of Exhibits A, B and C).

⁵⁴ *Id.* at paras. 60–62, 66.

⁵⁵ *Id.* at para. 67.

⁵⁶ *Id.* at paras. 57–58.

with a disclosure document and the prospective franchisee shall receive the disclosure document not less than 14 days before the earlier of, (a) the signing by the prospective franchisee of the franchise agreement or any other agreement relating to the franchise . . .⁵⁷

Section 6 states: “The franchisee may rescind the franchise agreement, without penalty or obligation, no later than 60 days after receiving the document, if the franchisor failed to provide the disclosure document or a statement of material change . . .”⁵⁸ Relying on these provisions,⁵⁹ and reviewing the documentary evidence submitted by the franchisor,⁶⁰ the court held that the franchisor failed to provide adequate disclosure to the franchisee,⁶¹ and awarded the franchisee C\$45,000.00⁶² in compensation for expenses incurred in setting up the franchise operation.⁶³

Walden illustrates how inadequate franchise disclosure can lead to a franchisee’s right to rescind the franchise agreement. In particular, the franchisor was penalized for failing to provide proper financial statements (balance sheets), a list of franchisees, and a signed disclosure document⁶⁴—information that would have led the franchisee to reasonably rely upon transparent and updated information relating to the franchise business. The franchisor also failed to deal with a “material change” in that the franchisee wanted to operate the franchise outside of Alberta, and in Ontario.⁶⁵ The relocation of the franchise was a “material fact”⁶⁶ that considerably

⁵⁷ Arthur Wishart Act (Franchise Disclosure), O. Reg. 581/00 (Can.).

⁵⁸ *Id.*

⁵⁹ See *Walden*, CanLII at paras. 57–71, 74, 76, 79–90 (outlining the two sections of the law, and then applying the law to the facts of the case).

⁶⁰ See *id.* at paras. 79–90 (applying the facts of the case to the law).

⁶¹ See *id.* at para. 91 (stating that the disclosure documents the franchisors provided were “seriously deficient.”).

⁶² *Id.* at para. 94.

⁶³ See *id.* at para. 45 (explaining that the cost of setting up the franchise was \$45,000).

⁶⁴ See *id.* at paras. 60–62, 66, 91, 93 (detailing the problems with the disclosure documents, and then ruling that it was because of these deficiencies that the agreement was rescinded).

⁶⁵ See *id.* at paras. 29–32, 67, 91 (detailing the two agreements, the franchisor’s argument that there was no material change, and the court’s conclusion that the franchisor’s second agreement did not qualify as an amendment and therefore was not exempt under the Arthur Wishart Act.) Implicit in the court’s argument that the second agreement was not an amendment of the first is the fact that there were material changes in the second agreement. See *id.* at paras. 67, 91.

⁶⁶ See *id.* at paras. 82–83 (detailing what the court considers to be the two
continued . . .

influenced the franchisee's decision to invest with the franchise initially. The court expressed concern that franchisees should be given the opportunity to properly evaluate the disclosure prior to operating a franchise. Implicit in its reasoning is that a franchisor should maintain communication with the franchisee, especially when new agreements are made to change the location of the franchise.⁶⁷ If AG Connexions gave adequate disclosure with sufficient particularity to Walden that met the "substantial compliance" requirement, and maintained active communication, the court may have held in favour of the franchisor. That is, the franchisor could have successfully defended itself if it had shown its disclosure "substantially complied" with franchise legislation, even though it was not perfect disclosure.

In 2005, the Ontario Court of Appeal considered another matter at the appellate level, where the broad issue was whether adequate disclosure was provided by a franchisor to a franchisee in *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd.* ("*Dig This Garden*").⁶⁸ The narrower issue related to whether the trial judge correctly interpreted franchise legislation in awarding rescission and damages to the franchisee based on alleged non-disclosure by the franchisor.⁶⁹ The facts were that a franchisee was interested in purchasing a franchised business in the retail gardening and gifts industry.⁷⁰ The franchisors disclosed many disclosure documents, "but they did so in a piecemeal fashion."⁷¹ The franchisee claimed that the franchisor failed to provide proper disclosure documents under section 5 of Ontario's *Arthur Wishart Act*, and was therefore entitled to rescission and damages for incurring expenses in establishing the franchise under section 6 of the Act.⁷² The trial judge in the Ontario Superior Court of Justice held in favour of the franchisee, and ordered that the franchisor, along with its two officers and directors, were jointly and severally liable for failing to provide adequate disclosure documents to the franchisee.⁷³

biggest changes between the two agreements: the territory the agreement covered, and the price of the agreements).

⁶⁷ See *id.* at para. 90 (arguing that the franchisors needed to have provided a new disclosure when the territory covered by, and price of the franchise agreement were changed).

⁶⁸ *1490664 Ontario Ltd. v. Dig this Garden Retailers Ltd.*, 2005 CanLII 25181 (Can. Ont. C.A.).

⁶⁹ *Id.* at para. 14.

⁷⁰ *Id.* at paras. 4–5.

⁷¹ *Id.* at para. 2.

⁷² *Id.*

⁷³ *Id.* at para. 3.

The Ontario Court of Appeal upheld the trial court's decision, and based its reasoning on the form and content of the franchisor's disclosure documents.⁷⁴ In its disclosure, the franchisor provided two things: (1) *pro forma* statements of projected income and estimated expenses for franchise stores with different square footages; and (2) a draft franchise agreement.⁷⁵ The franchise agreement gave essential information about the franchisor's address, minimum levels of inventory, and royalty fees.⁷⁶ The franchisor representative went even further by going to the franchisee's lawyer's office to answer questions about the franchise.⁷⁷ The franchisee later attended a training session about the Dig This Garden franchise, received a buying plan, and was introduced to two suppliers in the franchise system.⁷⁸ Eventually, the franchise agreement was executed, and a copy was provided to the franchisee, along with copies of amendments to the agreement.⁷⁹

At some point, the franchisee opened the store, but it experienced financial losses.⁸⁰ Her lawyer then filed a "notice of rescission" to the franchisor, claiming that inadequate disclosure was given.⁸¹ On appeal, the Ontario Court of Appeal held in favour of the franchisee, reasoning that full disclosure made in one document and delivered at one time was essential in fulfilling the legislative requirement for providing adequate disclosure documents to the franchisee.⁸² The franchisor conceded that it provided only seventy percent of the disclosure, something that the court ruled would not allow a franchisee to make an informed decision about investing with the franchise.⁸³ In fact, the franchisee paid her franchise fee of C\$30,000.00 and assumed the risk of opening a franchise store. An interesting provision—section 5(4)(d) of the *Arthur Wishart Act*—states: "statements as prescribed for the purposes of assisting the prospective franchisee in making informed investment decisions."⁸⁴ This provision is relevant because of the oral discussions made between the franchisor's representative and the franchisee's lawyer.

⁷⁴ See *id.* at paras. 15–19 (detailing the court's reasoning, whereby the court relied on the contents of the various disclosures the franchisees received).

⁷⁵ *Id.* at para. 7.

⁷⁶ *Id.*

⁷⁷ *Id.* at para. 8.

⁷⁸ *Id.* at para. 9.

⁷⁹ *Id.* at para. 10.

⁸⁰ *Id.* at para. 11.

⁸¹ *Id.*

⁸² *Id.* at para. 11.

⁸³ *Id.*

⁸⁴ Arthur Wishart Act (Franchise Disclosure), O. Reg. 581/00 (Can.).

Dig This Garden is noteworthy because it shows that although a franchisor may go to great lengths to provide accurate and updated information to the franchisee, doing so in a piecemeal fashion will make the disclosure insufficient. That is, the franchisor should have provided the disclosure documents in one document and delivered it once to the franchisee. Unlike *Walden*, the franchisor in *Dig This Garden* showed its commitment to the deal by sending its representative to the franchisee's lawyer's office. But this personal meeting was external to the legislative requirement of providing accurate and timely disclosure with specific details that is not just preliminary in nature, but is extensive enough to make it "substantially comply" with franchise disclosure requirements under legislation. Despite the franchisor providing its projected income, estimated expenses, and contents of the franchise agreement, it admitted that only seventy percent of its disclosure was given to the franchisee.

The court suggested that this level of disclosure was not enough for a franchisee to review all the facts and figures to make an informed investment decision in the future of that franchise.⁸⁵ In fact, the franchisee's financial losses were a direct result of what appeared to be substantial disclosure, but nevertheless incomplete disclosure.⁸⁶ *Dig This Garden* is compelling because it shows how a court can go beyond the legislative "substantial compliance" requirement in that a franchisor needs only to show substantial disclosure, not perfect disclosure. Regardless, in this case, the seventy percent level of franchise disclosure was insufficient, and the court set a higher standard for a franchisor to provide more accurate disclosure. Indeed, the franchisor demonstrated its good faith and effort to strike a deal with the franchisee, but its disclosures lacked critical information that would enable a reasonable franchisee to make informed investment decisions.

In 2012, the Ontario Superior Court of Justice considered the issue of whether a franchisor fitness business provided adequate disclosure documents to a franchisee in *Burnett v. Cuts*.⁸⁷ Here, a franchisee sought rescission of a master franchise agreement against a franchisor, Cuts Fitness for Men, an incorporated business from the State of New Jersey.⁸⁸ Initially, a Letter of Intent (LOI) and an Ontario Master Development Agent Agreement were entered into between the franchisor and franchisee.⁸⁹ The LOI included terms related to the

⁸⁵ *Dig this Garden Retailers Ltd.*, 2005 CanLII 25181 at para. 17.

⁸⁶ *Id.* at para. 18.

⁸⁷ *Burnett v. Cuts*, 2012 CanLII 3358 (Can. Ont. Sup. Ct. J.).

⁸⁸ *Id.* at paras. 1, 7.

⁸⁹ *Id.* at para. 7.

franchisee's right to operate in Ontario and franchisee fee payments.⁹⁰ Moreover, a Uniform Franchise Offering Circular ("UFOC") was given to the franchisee for informational purposes only.⁹¹ The franchisee sought a master license to operate in Ontario, and other provinces.⁹² By doing so, the franchisee was promised payment to successfully locate franchise units for sale in Canada.

Early in the business relationship, the franchisor sent disclosure documents (including a draft franchise agreement) to the franchisee.⁹³ However, the Ontario Master Development Agent Agreement was not signed by both of the parties because the franchisee never received the final draft.⁹⁴ The franchisee wrote to the franchisor's representative to get paid for listing the franchise sales opportunities in Canada.⁹⁵ One month later, however, the franchisee received inadequate disclosure documents; they were inadequate because they were delivered more than fourteen days after the signing of the Letter of Intent, thereby violating the fourteen-day statutory period.⁹⁶ Thereafter, the franchisee sought rescission of the franchise agreement.⁹⁷ The court held that the franchisor's disclosure was inadequate and awarded damages to the franchisee for over C\$200,000.00.⁹⁸ The court reasoned that disclosure was inadequate because it:

- failed to meet the fourteen-day time limit for sending disclosure to a franchisee;
- was not delivered as one document;
- did not have any financial statements;
- did not have copies of all proposed franchise agreements (and other agreements);
- did not include the Ontario Master Development Agent Agreement (which included a guarantee, a confidentiality agreement, and non-competition agreement);
- was not certified (signed or dated) by the franchisor's representative;

⁹⁰ *Id.* at para. 18.

⁹¹ *Id.* at para. 10.

⁹² *Id.* at para. 15.

⁹³ *Id.* at para. 16.

⁹⁴ *Id.* at para. 23.

⁹⁵ *Id.* at para. 22.

⁹⁶ *Id.* at paras. 25–26.

⁹⁷ *Id.* at para. 30.

⁹⁸ *Id.* at para. 70.

- did not contain a list of all franchisees that were terminated, cancelled, or not renewed.⁹⁹

In this case there were multiple breaches of Ontario's statutory disclosure requirements. In finding inadequate disclosure, the court also held that the franchisor failed to communicate with the franchisee, particularly after the franchisee sought payment of fees after successfully locating Canadian franchise units for the franchisor.¹⁰⁰ After certain inquiries were made, the franchisee discovered that the franchisor was dealing with a rapid decline in sales in the United States, and was changing direction by branding for Cuts Fitness for Women. The court made reference to the Ontario Court of Appeal in *MDG Kingston Inc. v. MDG Computers Canada Inc.*, where it stated:

The [Act] was passed by the legislature of Ontario in 2000 to level the legal playing field between franchisees and franchisors by protecting franchisees when they enter into franchise agreements. The Act provides a drastic remedy against franchisors who do not provide prior disclosure, in the required disclosure document, of all the relevant information that franchisees may need before deciding whether to enter into a franchise arrangement and to sign the franchise agreement.¹⁰¹

The court further upheld the protection of franchisees' rights by quoting from another Ontario Court of Appeal matter in *6792341 Canada Inc. v. Dollar It Ltd.*, where it said: "The purpose of the legislation is to protect franchisees and the mechanism for so doing is the imposition of rigorous disclosure requirements and strict penalties for non-compliance. The legislation must be considered and interpreted in light of this purpose."¹⁰² *Burnett* illustrates how Canadian courts strictly apply the technical requirements of franchise legislation for disclosure documents, but it also stresses the importance of keeping open communication with the franchisee (particularly when payment is due). By failing to provide adequate disclosure documents

⁹⁹ *Id.* at para. 26.

¹⁰⁰ *Id.* at para. 21.

¹⁰¹ *Id.* at para. 34.

¹⁰² *Id.*

(such as financing statements, copies of executed agreements, having no representatives' signatures, and no list of franchisees being terminated), the franchisee had no opportunity to discover. By enforcing a rigorous standard using the statutory criteria, the court fulfilled the legislative intent of requiring substantial and timely disclosure. The idea is that substantial, accurate, and timely disclosure enables a franchisee to weigh the risks and benefits of a franchise prior to entering into agreement with a franchisor.

In 2013, *Aplouin Imports Ltd. v. Global Diaper Services Inc.*¹⁰³ (“*Aplouin*”) saw the Superior Court of Justice consider the issue of whether a franchisor baby diaper business adequately disclosed a franchise document to a prospective franchisee in compliance with section 5 of Ontario's *Arthur Wishart Act*. The franchisee entered into a franchise agreement with the franchisor, an Alberta-based corporation, to operate a business that supplied and washed baby cloth diapers in Ontario (Mississauga, Oakville, and Burlington).¹⁰⁴ The franchisee sought over C\$200,000.00 in damages pursuant to the remedial clause of the *Arthur Wishart Act* under section 6(6).¹⁰⁵ During their first meeting, the franchisor representatives gave various materials to the franchisee about diaper services, and addressed questions about the franchise business model.¹⁰⁶ Financial documentation was also provided to the franchisee.¹⁰⁷ However, the documents received by the franchisee were not bound in a single document, but rather, were prepared in piecemeal fashion (as in *Dig This Garden*).¹⁰⁸ The franchisee became frustrated in his dealings with the franchisor and later served a notice of rescission with respect to the franchise agreement.¹⁰⁹

After filing suit against the franchisor for inadequate disclosure, the franchisee found errors in the disclosure itself, and that no copy of a franchise agreement, despite being signed by the franchisee, was given in the disclosure.¹¹⁰ The franchisor responded that the franchisee was already a sophisticated businessman who had experience in franchising, and, on that basis, should have understood the nature of the franchise disclosure documents given to him.¹¹¹ As

¹⁰³ *Aplouin Imports Ltd. v. Global Diaper Services Inc.*, 2013 CanLII 2592 (Can. Ont. Sup. Ct. J.).

¹⁰⁴ *Id.* at paras. 7-9.

¹⁰⁵ *Id.* at para. 1.

¹⁰⁶ *Id.* at para. 8.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* at para. 14.

¹⁰⁹ *Id.* at para. 9.

¹¹⁰ *Id.* at paras. 17, 20, 24.

¹¹¹ *Id.* at paras. 8, 17.

such, according to the franchisor, there was no reason for the franchisee to complain about the deficiencies in the franchise disclosure itself.¹¹² The Ontario Superior Court of Justice rejected this argument,¹¹³ concluding that the degree of sophistication of a franchisee had nothing to do with the accuracy and timing of disclosure, as mandated by legislation.¹¹⁴

Rather, the court confirmed three requirements constituting adequate disclosure from *Dig This Garden*: (1) only one disclosure document is required; (2) information contained in the disclosure should be accurate, clear, and concise; and (3) the disclosure should be delivered at one time.¹¹⁵ Applying these rules, the court found that the franchisor provided insufficient information about the franchisor's history and corporate structure of shareholders.¹¹⁶ The court stressed how a franchisee should have an opportunity to review a single document at one time, so that an informed decision can be made as to whether or not to invest in the franchised business.¹¹⁷ This legislative requirement was echoed by Madam Justice MacFarland in *Dig This Garden*, where she stated:

The requirement that disclosure occur in the form of a single document is not an empty formal requirement. The legislature clearly envisioned that the purpose of the legislation . . . would be best fulfilled by giving prospective franchisees the opportunity to review a single document or documents, so that all the information is before them at the same time. It is simple common sense that 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.¹¹⁸

According to the court, it was clear that the legislature's intent was to impose strict technical requirements of both form and content upon a franchisor, and that these requirements superseded the business experience of a prospective franchisee, something that is more of a franchisor's subjective assessment and not a legal requirement. The court reasoned that any subjective requirement imposed on a

¹¹² *Id.* at para. 17.

¹¹³ *Id.* at para. 18.

¹¹⁴ *Id.*

¹¹⁵ *Id.* at para. 14.

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Dig This Garden Retailers Ltd.*, 2005 CanLII 25181 at para. 18.

franchisee would distort the plain meaning of the legislative intent by placing an unnecessary burden on a franchisee to become sophisticated enough in reviewing disclosure documents to make informed investment decisions on that basis.¹¹⁹ If this were the case, very few franchisees would qualify to forge business relations with any franchisor, as many prospective franchisees are new to the franchise business. The subjective criteria of business sophistication would hinder business and the freedom to contract.

Another important aspect of *Apblouin* was the court's focus on financial statements. The court held that the franchisor failed to provide two sources of financial statements: (1) audited financial statements for the most recent fiscal year; and (2) financial statements prepared with "generally accepted accounting principles"—two requirements that fall under section 3(1)(a) and (b) of Ontario's *Arthur Wishart Act*.¹²⁰ The court held that the franchisor only provided QuickBooks statements to the franchisee, documents from an accounting software program that are not prepared in accordance with generally accepted accounting principles.¹²¹ This failure to provide financial statements in compliance with acceptable accounting standards prevented the franchisee from making financial projections based on the financial history of the franchise. Because the franchisor's disclosure was deficient in so many ways, the court held that the disclosure did not qualify as a "disclosure document," and that the plaintiff franchisee may exercise a right of rescission under section 6(2) of the *Arthur Wishart Act*.¹²²

B. Franchisor Representatives' Signatures—Avoiding Misrepresentation

Adequate disclosure also includes the franchisor's verification of the form and content by way of providing signatures of its directors or officers. The seminal case for the requirement of signatures is *Hi Hotel Ltd. Partnership v. Holiday Hospitality Franchising Inc.*,¹²³

¹¹⁹ Interestingly, the defendant franchisor admitted to the errors in the franchise disclosure documents given to the plaintiff franchisee. *Apblouin Imports Ltd.*, 2013 CanLII 2592 at para. 22.

¹²⁰ S. 3(1) of the *Arthur Wishart Act* states the following: "Every disclosure document shall include, (a) an audited financial statement for the most recently completed fiscal year of the franchisor's operations; (b) a financial statement for the most recently completed year of the franchisor's operations, prepared in accordance with generally accepted accounting principles . . ."

¹²¹ *Apblouin Imports Ltd.*, 2013 CanLII 2592 at paras. 36–37.

¹²² *Id.* at para. 45.

¹²³ *Hi Hotel Ltd. Partnership v. Holiday Hospitality Franchising Inc.*, 2008 *continued . . .*

where the Alberta Court of Appeal considered the issue of whether a franchisee had the right to rescind a franchise agreement when the franchisor provided no signatures in its disclosure documents. The facts were that a franchisee was interested in purchasing a Holiday Inn franchise.¹²⁴ The franchisor provided an Ontario disclosure document, along with an Alberta addendum.¹²⁵ However, the franchisor did not provide any signed certificates by their representatives.¹²⁶ The franchisee admitted that the signatures component of the disclosure document was not a factor in deciding whether or not to participate in the franchise.¹²⁷

At trial, the Alberta Court of Queen's Bench (trial court) held that the franchisee was entitled to seek rescission of the franchise agreement, along with damages.¹²⁸ Although the Alberta *Franchises Act* requires a franchisee to provide a Notice of Rescission within sixty days of receiving a disclosure document, the franchisee gave notice eleven months after the franchise agreement was signed.¹²⁹ On this basis, the franchisor appealed to the Alberta Court of Appeal by arguing that the franchisee was not entitled to rescission due to the timing requirement breach.¹³⁰ The Alberta Court of Appeal held that the franchisor failed to provide adequate disclosure because there was an absence of signatures and dates on the certificates, which was equivalent to having no disclosure at all.¹³¹ The court pointed to serious deficiencies in Holiday Inn's franchise disclosure document.¹³² First, the franchisor never actually had copies of its disclosure document, and only generic copies were on file at Holiday Inn's head office in the United States.¹³³ Second, there was no cover letter to accompany the disclosure document.¹³⁴

Third, the receipts were missing the date of the disclosure document.¹³⁵ Fourth, the certificate forms had no signatures—only the typed name for Holiday Inn and the franchisor's representative, along with the word “per” below it.¹³⁶ The Court of Appeals then compared

CanLII 276 (Can. Alta. C.A.).

¹²⁴ *Id.* at para. 277.

¹²⁵ *Id.* at para. 4.

¹²⁶ *Id.* at para. 124.

¹²⁷ *Id.* at para. 47.

¹²⁸ *Id.* at para. 300.

¹²⁹ *Id.* at para. 299.

¹³⁰ *Id.*

¹³¹ *Id.* at para. 135.

¹³² *Id.* at para. 300.

¹³³ *Id.* at para. 79.

¹³⁴ *Id.* at para. 5.

¹³⁵ *Id.* at para. 4.

¹³⁶ *Id.* at para. 36.

manual signatures versus typed names standing alone by reviewing Alberta's Commissioner for Oaths Act,¹³⁷ holding that typed names have no signatory effect as opposed to manual signatures.¹³⁸ The Court of Appeal ruled against the franchisor, as well as its directors and officers, both being held jointly and severally liable for failing to disclose signed certificates.¹³⁹ *Hi Hotel* is compelling in terms of having a franchisor verify its own form and content of disclosure given to franchisees in that:

The purpose of a certificate 'signed' by an official 'is personally to authenticate a document and implies knowledge and approval of its contents' . . . A certificate involves checking facts and confirming to the outside world that one has checked. . . . Without a certificate, the franchisee has just some random statements and pieces of paper, but nothing to tie them together or even to say that they are true.¹⁴⁰

Following this statement, which was drawn from the reasoning in *Dig This Garden*, the Alberta Court of Appeal further commented on how signatures relate to personal liability of the franchisor when they fail to provide adequate disclosure. It stated:

A person who signs the certificate has a personal duty to conduct an investigation sufficient to provide reasonable grounds for believing that the facts stated are accurate, and that all facts to be disclosed were disclosed. Personal liability enforces that. If no one signs, no one has that duty. . . . So a signed certificate is not a question of form. It governs who has huge monetary liability, and who has the duty of investigation and disclosure.¹⁴¹

The court's opinion speaks to the essence of franchise disclosure—to provide authentic documents that have been verified by franchisor representatives, and to give a chance to franchisee investors to later make informed investment decisions based on the truth or veracity of such documents. The Court of Appeal stressed the importance of disclosure in administrative and criminal cases, where disclosure gives an opportunity for one to review the record at hand, make informed

¹³⁷ RSA 2000, c. C-20, s.12 (Can.).

¹³⁸ *Hi Hotel Ltd. Partnership*, 2008 CanLII 276, at para. 36.

¹³⁹ *Id.* at para. 117.

¹⁴⁰ *Id.* at paras. 53, 55, 59.

¹⁴¹ *Id.* at paras. 73-75.

decisions on that record, and to challenge the opposing party on key issues. Keeping with this principle of disclosure, franchisees should be capable of reviewing and verifying background franchise documents that would ultimately affect their ability to make an informed business decision. The more detailed the disclosure (such as including history of the franchise, corporate structure, goods and services, and financial statements), the more it influences a franchisee to invest using their personal savings and/or borrowed funds to enter into agreement with a franchisor.

In *Hi Hotel*, the franchisor's disclosure document was missing two signatures from its directors or officers, something that breached Section 13 of Alberta's *Franchises Act*, which requires disclosure that is in "substantial compliance" with legislation.¹⁴² The franchisor argued that the franchisee did not rely on the representations contained in the disclosure document, and that this led to no cause of action.¹⁴³ The court disagreed.¹⁴⁴ It held that what mattered most was whether the disclosure document was "substantially complete or not," and that a breach occurred when the franchisor failed to provide two signatures.¹⁴⁵ When a franchisor provides two signatures, they are confirming the accuracy of "material facts" that may be relied upon by a prospective franchisee when deciding whether or not to invest in a franchise. This type of detrimental reliance gives rise to a statutory right of rescission.

Although the legislative intent gives flexibility to franchisors by requiring disclosure to be "substantially complete" (and not perfect disclosure), lacking two signatures does not fulfill this requirement in form. The two signatures show accountability and transparency in the franchisor's preparation of documents, so that if there is a misrepresentation of material facts, the franchisee at least has the opportunity to seek damages on that basis.¹⁴⁶ The *HiHotel* ruling balances the franchisor-franchisee relationship, as it imposes strict legal requirements upon the franchisor (who is usually in a superior bargaining position) to give the best chance to a prospective franchisee to thoroughly review key franchise documents. It also affords protection to franchisees while doing so.

Thus, when a franchisor provides no signatures in its disclosure document, a franchisee may likely succeed in rescinding a franchise agreement. So, what happens when there is only one signature in the

¹⁴² *Id.* at para. 136.

¹⁴³ *Id.* at para. 48.

¹⁴⁴ *Id.* at para. 49.

¹⁴⁵ *Id.* at para. 100.

¹⁴⁶ *Id.* at para. 69.

disclosure document? In *1448244 Alberta Inc. v. Asian Concepts Franchising Corporation*¹⁴⁷ (“*Asian Concepts*”), the Court of Queen’s Bench of Alberta considered the issue of whether a franchisee may rescind a franchise agreement under the “substantial compliance” provision (Section 13 of the Alberta *Franchises Act*) when a franchisor provides disclosure lacking two signatures. The facts were that the franchisee alleged that the defendant franchisor had provided “deficient” documents, particularly where there was a lack of two signatures of the franchisor’s representatives, and that this was not “substantially complete.”¹⁴⁸ The franchisor provided some documentation, but only one signature was made by the franchisor’s representative.¹⁴⁹ The court held that the franchisor failed to provide adequate disclosure because the disclosure document had only one signature of a representative, and not two signatures.¹⁵⁰ The court followed the rule established in *Emerald Developments Ltd. v. 768158 Alberta Ltd.*,¹⁵¹ where the Court of Queen’s Bench of Alberta held that one signature provided in a franchisor’s disclosure document was a serious deficiency in its disclosure, which amounted to inadequate disclosure.¹⁵²

Three rules were highlighted in *Asian Concepts*. First, if proper disclosure is not made, a franchisee may rescind the franchise agreement and recover net losses incurred in acquiring, creating and operating the franchised business.¹⁵³ Second, under *Regulation 2(3)* of Alberta *Franchises Regulation*, a disclosure document must include a certificate signed by at least 2 officers or directors.¹⁵⁴ Third, section 9 of Alberta’s *Franchises Act* states that if a franchisee suffers any loss from misrepresentation contained in a disclosure document, a franchisee has a right to seek damages against the franchisor (and anyone signing the disclosure document).¹⁵⁵ Thus, the second signature was important not only because it breached the “two

¹⁴⁷ *1448244 Alberta Inc. v. Asian Concepts Franchising Corp.*, 2013 CanLII 221 (Can. Alta. Q.B.).

¹⁴⁸ *Id.* at para. 17.

¹⁴⁹ *Id.* at para. 8.

¹⁵⁰ *Id.* at para. 23.

¹⁵¹ *Emerald Devs. Ltd. v. 768158 Alberta Ltd.*, 2001 CanLII 143 (Can. Alta. Q.B.).

¹⁵² *Id.* at para. 29.

¹⁵³ *Franchises Act*, R.S.A. 2000, c F-23 (Can.).

¹⁵⁴ *Franchises Regulation*, Alta. Reg. 240/1995 (“A disclosure document, including any material changes made in respect of a disclosure document, must include a certificate set out in Schedule 2 that must be dated and must be signed (a) by at least 2 officers or directors of the franchisor, or a combination of them totaling at least 2, if the franchisor has 2 or more directors or officers.”).

¹⁵⁵ *Franchises Act*, R.S.A. 2000, c F-23 (Can.).

signatures” requirement, but also because it prevented the franchisee from seeking damages against a second signatory. That is, the franchisor limited its personal liability of two signatories when making disclosure to the franchisee with only one signatory. Interestingly, like *Hi Hotel*, the franchisee in *Asian Concepts* downplayed the prospect of misrepresentation in disclosure, admitting that parts of the disclosure document were not misrepresented to him.¹⁵⁶ Regardless, the court held against the franchisor on the basis that any minor deviation from legislative disclosure requirements were not permitted.¹⁵⁷

C. Failure to Provide “Material Facts” and Misrepresentation

Other cases reveal how a franchisor’s failure to provide “material facts” in a series of disclosure documents may amount to an actionable claim for misrepresentation, in which a franchisee detrimentally relies upon such disclosure when investing in the franchise, and later experiences financial losses.¹⁵⁸ As shown, franchise legislation in Canada creates a statutory right of rescission for a franchisee when there is proof that “material facts” were not given to a franchisee or franchisor. In *Melnychuk v. Blitz Limited*¹⁵⁹ (“*Melnychuk*”), the Ontario Superior Court of Justice considered the issue of whether “material facts” were omitted from a franchisor’s disclosure documents to have them make a properly informed decision about whether or not to invest in the franchise. The facts were that a franchisee, an incorporated business in Ontario by Melnychuk, entered into a franchise agreement with the franchisor, Dollar Blitz Store.¹⁶⁰ Various disclosure documents were provided by the franchisor’s representative to Melnychuk, after which he signed a receipt acknowledging the documents, including a franchise agreement, general security agreement, lease and sublease, a purchase and sale agreement, and financial statements.¹⁶¹

The court found deficiencies in the disclosure documents. First, the financial statements contained a notice which stated: “We have compiled the balance sheet . . . We have not audited, reviewed or otherwise attempted to verify the accuracy or completeness of such information. Readers are cautioned that these statements may not be

¹⁵⁶ *Hi Hotel Ltd. Partnership*, 2008 CanLII 276, at para. 134.

¹⁵⁷ *Id.* at para. 136.

¹⁵⁸ *Ontario Inc. v. Pillar to Post Inc.*, 2013 CanLII 4374 (Can. Ont. Sup. Ct. J.).

¹⁵⁹ *Melnychuk v. Blitz Ltd.*, 2010 CanLII 566 (Can. Ont. Sup. Ct. J.).

¹⁶⁰ *Id.* at para. 1.

¹⁶¹ *Id.* at para. 7.

appropriate for their purposes.”¹⁶² Given that Ontario's *Arthur Wishart Act* required accurate, updated financial statements that should be verified by auditing and generally accepted accounting principles, the franchisor failed in this respect.¹⁶³ Clearly, the franchisor admitted in its own notice that the financial statements were incomplete and were not verified.¹⁶⁴ The issue is whether a reasonable franchisee investor would rely upon such disclosure when making a serious financial commitment to a franchise.

Second, the location of the franchised business was missing from the franchise agreement.¹⁶⁵ This was left blank, and the location was given to the franchisee much later in time. Third, there was no disclosure as to the purchase price, franchise fee, deposits, or closing date (for the purchase and sale agreement).¹⁶⁶ This breached the legislative requirement under section 5(4)(a) of the *Arthur Wishart Act*, which requires a list of all franchisee's costs to establish the franchise. Third, no lease or sublease was included with the disclosure document, with the consequence being that Melnychuk was not given sufficient notice for the term of the lease or its calculated rent, which placed Melnychuk as an “indemnifier” to indemnify the franchisor against any loss or damages arising out of the sublease.¹⁶⁷ This failure to provide relevant contents of the sublease exposed the franchisee's personal liability for the indemnification portion of the sublease. Without the sublease information, how would the franchisee be aware of his obligations against any loss or damage arising from the sublease?¹⁶⁸ Fourth, the general security agreement was incomplete in that the last five pages of the document were missing.¹⁶⁹ Given these disclosure defects, Melnychuk moved to rescind the franchise agreement under section 6(2) of Ontario's *Arthur Wishart Act* on the ground that the disclosure document failed to provide “material facts,” thereby resulting in no disclosure.¹⁷⁰

The court agreed that multiple deficiencies in the franchisor's disclosure documents prevented the franchisee from making an informed decision, and that the franchisee was entitled to rescind the

¹⁶² *Id.* at para. 11.

¹⁶³ *Id.*; *Arthur Wishart Act (Franchise Disclosure)*, O. Reg. 581/00 (Can.).

¹⁶⁴ Melnychuk, 2010 CanLII 566 at para 11.

¹⁶⁵ *Id.*

¹⁶⁶ *Id.*

¹⁶⁷ *Id.* at paras. 7-8.

¹⁶⁸ *Id.* at para. 8. The issue of omitting material facts from a franchise sublease was also considered in *6792341 Canada Inc. v. Dollar It Ltd.*, 2009 CanLII 385 (Can. Ont. C.A.).

¹⁶⁹ Melnychuk, 2010 CanLII 566 at 9.

¹⁷⁰ *Id.* at para.10.

franchise agreement, general security agreement, and indemnity agreement, along with the sublease.¹⁷¹ The franchisee was awarded damages of C\$266,690.00 relating to the costs of establishing and maintaining the franchised business, including the franchise fee, cost of a business plan, legal and accounting expenses, rent deposit, payment for goodwill, right to sublet, chattels, furniture, fixtures, equipment, and inventory.¹⁷² *Melnychuk* is instructive because it shows how a franchisor's partial disclosure would lead a franchisee to rely to their detriment on incomplete and inaccurate information that, under the legislative scheme, amounts to inadequate franchise disclosure. The franchisee was seriously concerned with the lack of completeness in the disclosure documents, particularly with the material fact of the remaining term of the lease. The deficient disclosure hindered the franchisee's ability to determine how long he could operate the franchise on the premises.

The issue of omitting a material fact of a lease renewal in one's disclosure document reappeared in 2012 in *Sirianni. v. Country Style* ("*Country Style*").¹⁷³ In this case, the Ontario Superior Court considered the issue of whether a franchisor deliberately concealed disclosure about the term of a sublease.¹⁷⁴ In this case, a franchisee entered into an agreement with the franchisor (Country Style) in 1995, and developed a solid ten-year business relationship in selling coffee, donuts, and sandwiches.¹⁷⁵ Upon the renewal of the franchise agreement, part of which included a sublease on the premises of where the store was located, there was a renewal of the franchise agreement for an additional five years.¹⁷⁶ However, the franchisee argued that inadequate disclosure was provided to them during the renewal period, and that "material facts" were deliberately omitted by the franchisor.¹⁷⁷ What was missing was a sublease that would have revealed that the lease for the premises was expiring soon. In fact, the franchisor agreed with the landlord of the commercial premises to set an early termination date, but failed to disclose this material fact to the franchisee.¹⁷⁸

¹⁷¹ *Id.* at para 15.

¹⁷² *Id.* at para 16. The court in *Melnychuk* also considered damages for loss of income, emotional distress, and punitive damages, but left this assessment of damages until after the discovery phase of litigation. *Id.* at paras. 16–17.

¹⁷³ *Sirianni v. Country Style*, 2012 CanLII 881 (Can. Ont. Sup. Ct. J.) at para. 17.

¹⁷⁴ *Id.* at para. 21.

¹⁷⁵ *Id.* at para. 2-3.

¹⁷⁶ *Id.* at para. 2.

¹⁷⁷ *Id.*

¹⁷⁸ *Id.* at para.10.

On this basis, the franchisee sought rescission of the renewed franchise agreement.¹⁷⁹ The court held that the franchisor deliberately withheld showing the renewal terms of the sublease on the commercial premises because they feared the franchisee would leave the premises, and the franchisor would become responsible for paying the rent on the sublease.¹⁸⁰ In essence, the omission of material facts relating to the sublease's renewal terms prevented the franchisees from planning ahead, while exposing him to personal liability as an indemnifier. The court was mindful of these points and protected the franchisee from this type of misrepresentation by awarding damages in their favour.¹⁸¹ Thus, it became clear that the rule for adequate franchise disclosure was that a franchisor is required to submit material facts, including those facts that may potentially lead an investor to personal liability, even on the renewal terms of a sublease.

D. Method of Delivery for a Disclosure Document

An important rule in franchise law is that a franchisor must deliver franchise disclosure documents either personally or by registered mail.¹⁸² This rule is based on legislative requirements set under franchise legislation. One question that remains is whether e-mail alone fulfills the method of delivery for franchise disclosure documents. In 2012, the Ontario Superior Court of Justice considered this issue in *Vijh et al v. Mediterranean Franchise Inc. et al*, a franchise selling Mediterranean foods.¹⁸³ Despite the franchisor fully complying with its form and content of disclosure, and despite the franchisee agreeing to receive the disclosure by e-mail, the issue of the delivery method of disclosure was in question because the franchisee sued for rescission and damages.¹⁸⁴

The court held that the franchisee could not recover damages and rescind the franchise agreement.¹⁸⁵ It reasoned that notwithstanding the missing statutory language in franchise legislation for including e-mails as a method of delivering disclosure documents, the franchisor

¹⁷⁹ *Id.* at para. 69.

¹⁸⁰ *Id.* at para. 123.

¹⁸¹ *Id.* at para. 131.

¹⁸² See e.g., Arthur Wishart Act (Franchise Disclosure), O. Reg. 581/00 (Can.) (describing, among others requirements, the need to ensure delivery of franchise disclosure documents either personally or by registered mail).

¹⁸³ *Vijh et al v. Mediterranean Franchise Inc. et al*, 2012 CanLII 3845 (Ont. Supt. Ct. J.).

¹⁸⁴ *Id.* at para. 2.

¹⁸⁵ *Id.* at para. 3.

did provide the necessary form and content of disclosure.¹⁸⁶ Drawing from another case on point in *4287975 Canada Inc. v. Imvescor Restaurants Inc.*, the Ontario Superior Court of Justice held that not every breach under franchise legislation justifies a franchisee's right to rescission.¹⁸⁷ The rule for rescission is that it is permitted within two years after entering the franchise agreement if "no disclosure document" or a "material deficient disclosure" was made by a franchisor.¹⁸⁸ The right of rescission within the two-year period is only available to a franchisee where it is shown that a franchisor provided no disclosure at all.¹⁸⁹ Here, the franchisor provided complete disclosure, and although it delivered it by e-mail (rather than personally or by registered mail), it was not a material breach under statute. Thus, minor technical breaches of franchise legislation with respect to method of delivery does not necessarily justify a claim for rescinding a franchise agreement, particularly when almost two years had elapsed after the signing of the franchise agreement.

As shown, franchise case law describe how courts protect franchisees' rights for franchise disclosure documents. It is no longer enough for a franchisor to give a bare minimum of documents (particularly those without executed signatures), and later assume that a franchisee may rely upon such disclosure to make an informed decision on investing in the franchised business. Rather, the courts look to the content and form of the disclosure provided by franchisors to determine whether or not compliance is met under the technical criteria of franchise legislation. The courts recognize the growing presence of franchises in the Canadian marketplace, and that a stable franchisor-franchisee relationship is best achieved.

IV. SUMMARY OF RULES FOR ADEQUATE FRANCHISE DISCLOSURE

From a practical viewpoint, a franchisor can meet their legislative duty of disclosure to prospective franchisees, and avoid a franchisee's rescission claims by following some tips:

- provide "one document" at one point in time, and avoid giving disclosure in a piecemeal fashion;

¹⁸⁶ *Id.* at para. 6.

¹⁸⁷ *4287975 Canada Inc. v. Imvescor Restaurants Inc.*, 2009 CanLII 48123 (Can. Ont. Sup. Ct. J.).

¹⁸⁸ *Id.* at para. 22.

¹⁸⁹ *Id.*

- provide accurate and updated financial statements, which meet auditing and generally accepted accounting principles standards;
- have signatures from at least two franchise representatives;
- provide copies of supplementary documents, including a franchise agreement, general security agreement, lease or sublease, or purchase and sale agreement;
- avoid omitting “material facts” in the disclosure documents (such as location, fees, lease terms);
- maintain regular communication with franchisee when they request information;
- deliver the franchise disclosure document within fourteen days prior to signing any agreement, and by way of personal service, registered mail, or e-mail.

V. CONCLUSION

Franchises are becoming a popular means of doing business in Canada for prospective investors. As such, the franchisor-franchisee relationship becomes important from a legal perspective when prospective franchisees request disclosure documents from the franchisor and rely upon such documents. Recent case law has revealed how inadequate disclosure can adversely affect a franchisee’s ability to use that information and make an informed decision to invest in the franchised business. In response, franchise remedial legislation was introduced to spell out with precision what a franchisor must provide in its disclosure documents to a franchisee. The courts have strictly enforced this technical criteria as to the form and content of disclosure. Legislative provisions thus provide a strong layer of legal protection for the franchisees against franchisors failing to meet this requirement.

The technical requirements discourage generic disclosure, poor record-keeping, and distributing disclosure documents in a piecemeal fashion. In addition, prescribing proper accounting standards enhances transparency and accountability of the franchisor. What can be gleaned from the case law is that courts recognize the major risk undertaken by franchisees when they invest in a franchise. Pursuing a franchise requires serious financial resources and commitment on the part of the franchisee, and because of the relatively unequal bargaining positions between franchisors and franchisees (where one-sided terms and conditions are found in franchise agreements), the courts have enforced the remedial portions of franchise legislation to protect

franchisees from possible future financial losses when relying on incomplete disclosure. The remedial provisions of legislative disclosure requirements demands high quality in the form and content of disclosure, by which a franchisee can make reasonable investment decisions. In this way, franchise legislation protects franchisees' rights, disciplines the behavior of franchisors, and fosters a more stable business relationship in the franchise sector.