

OBA Institute 2012
Dealing with and Litigating Disputes Involving Franchises

The Arthur Wishart Act (Franchise Disclosure), 2000

An Overview

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Purpose:

- Regulation of the franchise marketplace
- Protection of prospective and current franchisees
- Compensate for perceived imbalance of power

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3 Key Elements:

- The obligation imposed on franchisors to provide disclosure
- The duty of fair dealing imposed on each party to a franchise agreement
- The right of franchisees to associate

"franchise"

means a right to engage in a business where the franchisee is required by contract or otherwise to make a payment or continuing payments, whether direct or indirect, or a commitment to make such payment or payments, to the franchisor, or the franchisor's associate, in the course of operating the business or as a condition of acquiring the franchise or commencing operations and, ,

(a) in which,

(i) the franchisor grants the franchisee the right to sell, offer for sale or distribute goods or services that are substantially associated with the franchisor's, or the franchisor's associate's, trade-mark, service mark, trade name, logo or advertising or other commercial symbol, and

(ii) the franchisor or the franchisor's associate exercises significant control over, or offers significant assistance in, the franchisee's method of operation, including building design and furnishings, locations, business organization, marketing techniques or training, or

(b) in which,

(i) the franchisor, or the franchisor's associate, grants the franchisee the representational or distribution rights, whether or not a trade-mark, service mark, trade name, logo or advertising or other commercial symbol is involved, to sell, offer for sale or distribute goods or services supplied by the franchisor or a supplier designated by the franchisor, and

(ii) the franchisor, or the franchisor's associate, or a third person designated by the franchisor, provides location assistance, including securing retail outlets or accounts for the goods or services to be sold, offered for sale or distributed or securing locations or sites for vending machines, display racks or other product sales displays used by the franchisee;

Franchisor's obligation to disclose

5(1) A franchisor shall provide a prospective franchisee 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; and

(b) the payment of any consideration by or on behalf of the prospective franchisee to the franchisor or franchisor's associate relating to the franchise



Contents of disclosure document

The disclosure document shall contain,

- (a) all material facts, including material facts as prescribed;
- (b) financial statements as prescribed;
- (c) copies of all proposed franchise agreements and other agreements relating to the franchise to be signed by the prospective franchisee;
- (d) statements as prescribed for the purposes of assisting the prospective franchisee in making informed investment decisions; and
- (e) other information and copies of documents as prescribed



"material fact"

includes any information about the business, operations, capital or control of the franchisor or franchisor's associate, or about the franchise system, that would reasonably be expected to have a significant effect on the value or price of the franchise to be granted or the decision to acquire the franchise



Certification

O. Reg. 581/00, s. 7

- (1) Every disclosure document shall include a certificate certifying that the document,
 - (a) contains no untrue information, representations or statements; and
 - (b) includes every material fact, financial statement, statement and other information required by the Act and this Regulation
- (2) A certificate referred to in subsection (1) shall be signed and dated by,
 - (a) in the case of a franchisor that is not incorporated, the franchisor;
 - (b) in the case of a franchisor that is incorporated and has only one director or officer, by that person;
 - (c) in the case of a franchisor that is incorporated and has more than one officer or director, by at least two persons who are officers or directors



Delivery Requirements

- A disclosure document may be delivered personally, by registered mail or by any other prescribed method
- A disclosure document must be one document, delivered ...as one document at one time
- All information in a disclosure document and a statement of a material change shall be accurately, clearly and concisely set out

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Rescission Remedy

Rescission for late disclosure

6.(1) A franchisee may rescind the franchise agreement, without penalty or obligation, no later than 60 days after receiving the disclosure document, if the franchisor failed to provide the disclosure document or a statement of material change within the time required by section 5 or if the contents of the disclosure document did not meet the requirements of section 5.

Rescission for no disclosure

(2) A franchisee may rescind the franchise agreement, without penalty or obligation, no later than two years after entering into the franchise agreement if the franchisor never provided the disclosure document

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Franchisor's obligations on rescission

The franchisor, or franchisor's associate, as the case may be, shall, within 60 days of the effective date of the rescission,

- a) refund to the franchisee any money received from or on behalf of the franchisee, other than money for inventory, supplies or equipment;
- b) purchase from the franchisee any inventory that the franchisee had purchased pursuant to the franchise agreement and remaining at the effective date of rescission, at a price equal to the purchase price paid by the franchisee;
- c) purchase from the franchisee any supplies and equipment that the franchisee had purchased pursuant to the franchise agreement, at a price equal to the purchase price paid by the franchisee; and
- d) compensate the franchisee for any losses that the franchisee incurred in acquiring, setting up and operating the franchise, less the amounts set out in clauses (a) to (c).



Leading Disclosure Cases

1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd. [2005] O.J. No. 3040

- Main purpose of the Act is the obligation imposed on the franchisor to make full and accurate disclosure so that a prospective franchisee can make an informed decision about investing in the franchise opportunity
- Strict compliance with the disclosure requirements of the Act and the Regulations is required
- If the disclosure document does not comply it will be deemed not to be a disclosure document
- Disclosure provided to a prospective franchisee piecemeal over a period of time does not meet the Act's requirements.



Leading Disclosure Cases

686289 Canada Limited v. Dollar It Limited

Ontario Court of Appeal - "Ss. 6(1) and 6(2) must be read and interpreted broadly"

Deficiencies noted by the Court included:

- ✓ Signed and dated Certificate of Disclosure;
- ✓ Financial statements or an opening balance sheet;
- ✓ Copy of the lease for the premises under which the franchisee was the subtenant;
- ✓ Information on the franchisor's affiliate which was the tenant and sublandlord of the premises;
- ✓ Prescribed information pertaining to the franchisor's advertising program; and
- ✓ Description of the exclusive territory to be granted and the franchisor's policy on proximity between the franchisees.

Each of the foregoing was material information required for the franchisee to make an informed investment decision

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Leading Disclosure Cases

Sovereignty Investment Holdings, Inc. v. 9127-6907 Quebec Inc.

The Court identified four deficiencies in a disclosure document, any of which was fatal to compliant disclosure:

- Failure to include financial statements
- Failure to include a statement specifying the basis for earnings projections provided in the disclosure document
- Failure to provide disclosure in a single document at one time; and
- The absence of a signed certificate of disclosure

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Damages for misrepresentation, failure to disclose

7(1) If a franchisee suffers a loss because of a misrepresentation contained in the disclosure document or in a statement of a material change or as a result of the franchisor's failure to comply in any way with section 5, the franchisee has a right of action for damages

Misrepresentation includes "an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in the light of the circumstances in which it was made."

Deemed reliance by the franchisee where there is a misrepresentation in a disclosure document.

DUTY OF FAIR DEALING

3(1) Every franchise agreement imposes on each party a duty of fair dealing in its performance and enforcement

...the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards.

THE DUTY OF FAIR DEALING

Shelanu v. Print Three

- Establishment of a downmarket print franchise near an existing Print Three location was contrary to the duty of good faith

Katokidis v. Mr. Submarine

- Punitive damages awarded for the franchisor's breach of the duty of fair dealing where franchisor opened a competing franchise

Salah v. Timothy's Coffees of the World Inc.

- the franchisor breached the duty of fair dealing where it deliberately interpreted the franchise agreement renewal provisions in order to avoid renewal of the franchise agreement by an existing franchisee



RIGHT OF ASSOCIATION

4(1) *A franchisee may associate with other franchisees and may form or join an organization of franchisees.*

(2) *A franchisor and a franchisor's associate shall not interfere with, prohibit or restrict, by contract or otherwise, a franchisee from forming or joining an organization of franchisees or from associating with other franchisees.*

(3) *A franchisor and franchisor's associate shall not, directly or indirectly, penalize, attempt to penalize or threaten to penalize a franchisee for exercising any right under this section.*

(4) *Any provision in a franchise agreement or other agreement relating to a franchise which purports to interfere with, prohibit or restrict a franchisee from exercising any right under this section is void.*

S. 4 has been interpreted to validate a franchisee's participation in a class action claim against its franchisor (*405341 Ontario Limited v. Midas Canada Inc.*).



RIGHTS CANNOT BE WAIVED

11. *Any purported waiver or release by a franchisee of a right given under this Act or of an obligation or requirement imposed on a franchisor or franchisor's associated by or under this Act is void.*

405341 Ontario Limited v. Midas Canada Inc.

- A release given as a condition to assignment or renewal is *prima facie* void pursuant to s. 11 and the requirement to provide the release is unenforceable.

But see: 1518628 Ontario Inc. v. Tutor Time Learning Centre

- Release is valid where given for valuable consideration as part of a settlement of an action between the franchisor and franchisee, in respect of an existing, known claim by an informed franchisee who has had the benefit of independent legal advice.

Preparation and Review of Disclosure Documents

Information gathering

- Data typically collected by questionnaire and supplemented with interviews
- Quality of questionnaire is key.
- Must provide not only prescribed disclosure but also other material facts which may impact on price of franchise or on decision to acquire franchise
- Consider whether internal matters need to be disclosed:
 - Ownership changes
 - Shareholder disputes
 - System changes
 - Decisions to acquire systems
 - Changes to business mix/new products etc.
 - Pending or threatened lawsuits

Preparation and Review of Disclosure Documents

Sufficiency of Disclosure

- Document delivered as one document at one time and must be complete
- In *1490664 Ontario Ltd. V. Dig this Garden* – piecemeal delivery resulted in a finding that no disclosure document was provided
- Failure to disclose certain critical information, including the signed certificate, details of franchisor's associates and required financial disclosures, can invalidate disclosure (see *6792341 Canada Inc. v. Dollar It Limited, Hi Hotel, Sovereignty*)
- AB and PEI allow “substantial disclosure”. Manitoba Act permits piecemeal delivery subject to conditions.

Preparation and Review of Disclosure Documents

Methods of Delivery and Receipt

- Ontario Act requires delivery in person or by registered mail. Packages often exceed the weight limit and courier with delivery receipt often employed.
- PEI and NB Acts permit delivery by courier and electronic means, and PEI permits disclosure in machine-readable media
- Electronic Commerce Act suggests that electronic disclosure would be acceptable in Ontario if functional equivalency rules observed but this is not common practice and has risks
- 14 day count begins on date of signed receipt

Material Change

Material change is defined in section 5(5) of the Act as:

- “a change in the business, operations, capital or control of the franchisor or franchisor’s associate, a change in the franchise system or a prescribed change, that would reasonably be expected to have a **significant adverse effect** on the value or price of the franchise to be granted or on the decision to acquire the franchise and **includes a decision** to implement such a change made by the board of directors of the franchisor or franchisor’s associate or by senior management of the franchisor or franchisor’s associate who believe that confirmation of the decision by the board of directors is probable”
- Franchisor must deliver written statement detailing any material change as soon as practicable after the change and prior to execution of any franchise agreement or payment of consideration
- Timing and format are not prescribed but the statement should be delivered and certified in the manner prescribed

Correcting a Disclosure Document

Scenario One:

- If the Franchise Agreement has not been signed, retract the earlier FDD, reissue the corrected document and reset the clock

Scenario Two:

- If the FA has been signed, then franchisor must weigh pros and cons
- Possible solution – deliver corrected FDD accompanied by offer to rescind franchise agreement; sign the new FA after 14 days if franchisee acquiesces

Correcting a Disclosure Document after the fact

- Failure to disclose deficiency subjects franchisor to potentially significant liability
- Disclosure may result in demand for consideration by franchisee
- Potential solution – deliver corrected disclosure accompanied by offer to rescind franchise agreement



Differences between Provincial Statutes

- Wholesale agreements not excluded from ON Act
- PEI, NB and AB Acts permit execution of confidentiality and site selection within the 14-day waiting period
- AB and PEI provide that substantially complete disclosure document satisfies requirements
- NB and PEI Acts permit delivery by courier and electronic means
- PEI, NB and AB Acts permit use of disclosure document prepared to comply with requirements of another jurisdiction
- Contracts with the Crown treated differently by various Acts
- ON Act requires disclosure for all directors and officers, regardless of role in management of franchisor
- NB Act contains a novel dispute resolution procedure



Conclusion

- Act is broadly interpreted to ensure remedial purpose of legislation is met
- In attempt to remedy imbalance of power, courts are strictly enforcing key provisions relating to disclosure obligations, fair dealing, rights to associate and anti-waiver provisions
- Current knowledge of laws and jurisprudence are essential



QUESTIONS?

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