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The Arthur Wishart Act (Franchise Disclosure), 2000 – An Overview

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THE ARTHUR WISHART ACT – AN OVERVIEW

1. A Brief History

It took more than 30 years to bring franchise legislation into Ontario. In 1970, the government of Ontario launched a comprehensive inquiry to review and report upon referral, pyramid or multi-level sales practice, and franchises. The Grange inquiry was commissioned to report upon the alleged financial abuse of franchisees by franchisors. The Grange Commission report was the initial basis for what ultimately led to passage by the Ontario Legislature, on May 17, 1995 of the Arthur Wishart Act (Franchise Disclosure), 2000[1] (the "Act"), formerly Bill 33. Many wonder, of course, how the Act came to be named.

Arthur Wishart was the Conservative MPP for Sault Ste Marie and the Minister of Financial and Commercials Relations under whose Ministry the committee was tasked with the mandate, the precise terms of reference being "*to report upon and to consider all aspects of the relationship of franchisors and franchisees and the implications of these arrangements to the consumer and the investor, and generally to recommend what, if any, changes in the law are desirable*." The review led to the Grange Report in 1971[2] which recommended:

(1) that Legislation be introduced to apply to all franchises within all industries;

(2) that a Franchisor be required to file prospectus setting forth detailed information on the franchise "scheme"

(3) that a Franchisee have a compulsory 48-hour cooling-off period before signing a franchise;

(4) that a Franchisee to have right to apply to Tribunal or Court to determine:

  (a) whether the contract is fair; and

  (b) whether conduct of franchisor is fair in circumstances;

(5) the Tribunal or Court have the authority to discourage following:

  (a) arbitrary termination

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[1] S.O. 2000, C.3. Also referred to herein as the "Ontario Act".
[2] The Grange Report can be found at: http://www.wikidfranchise.org/grange-report

(b) arbitrary refusal of assignment or renewals

(c) arbitrary forfeiture of deposits

(d) forced purchases and secret profits

(e) competitive and discriminating practices by franchisors

Little was done to implement the recommendations of the Grange Report notwithstanding the introduction in the United States, both at the federal level and in some US states, and in the Province of Alberta, of franchise-specific legislation. It was not until 1994, as a result of the publicity surrounding the dispute between Pizza Pizza and its franchisees, that the Ontario government formed the Franchise Sector Working Team to establish a framework for franchise legislation in Ontario.

Bill 33 "*An Act to require fair dealing between parties to franchise agreements, to ensure that franchisees have the right to associate and to impose disclosure obligations on franchisors*" was introduced in 1995 and, following significant public consultation, the Act received royal assent in June, 2000. Proclamation of the Act followed in 2 stages: first, all provisions of the Act other than the disclosure requirements came into force on July 1, 2000 with the disclosure requirements following on January 31, 2001.

In many ways, the Act followed Alberta's *Franchises Act*[3], which in its current form has been in force since 1995 (herein, the "Alberta Act"). The Act imposes on franchisors the requirement to provide disclosure to prospective franchisees of all "material facts", as defined in the Act, including matters prescribed by the Regulations[4] and imposes some restraints on the franchisor-franchisee relationship. All of these are discussed below in this paper.

Given the definition of "franchise", the application of the Act is far-reaching, and can include arrangements not intended by the parties to be a franchise. The definition, in Subsection 1(1) of the Act reads as follows (*emphasis added*):

> "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,

[3] RSA 2000, Chapter F-23

[4] Ontario Regulation 581/00

(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

As a result, any business arrangement that involves the sale or distribution of goods or services associated with another's trade-mark or brand may be a "franchise" under this definition so long as there is some payment element and an element of control or assistance. There is no exception from the payment element, as there is under Alberta's *Franchises Act* which provides for an exemption for payment by the franchisee of a reasonable amount of goods or services at a reasonable bona fide wholesale price. Further, there is no guidance provided in the definition as to what would be considered to be "significant" control or assistance.

2. The Key Elements of the Act

The aim of the Act is the regulation of the franchise marketplace and to protect both prospective franchisees and those already party to a franchise relationship. It is remedial legislation, intended to "level the playing field" and the perceived imbalance of power in the franchisor-franchisee relationship. Achievement of this goal is attempted through the following three key principles of the Act and the remedies made available to franchisees:

- the obligation imposed on franchisors to provide disclosure;

- the duty of fair dealing imposed upon the franchisor and franchisee; and
- the right of franchisees to associate

A franchisee has a right to rescind the franchise agreement, and a right of action for damages, arising from a franchisor's failure to comply with the disclosure requirements as well as a right of action for damages if the franchisor breaches the duty of fair dealing or restricts the franchisee's right to associate.

3. The Disclosure Obligation

Section 5 of the Act sets forth the disclosure obligation and requires that a franchisor provide a franchise disclosure document (or "FDD") to a prospective franchisee not less than 14 days before the earlier of the signing by the prospective franchisee of the franchise agreement *or any other agreement relating to the franchise* (*emphasis added*) and the payment of any consideration relating to the franchise. As "franchise agreement" is defined in the Act to include any agreement relating to the franchise, this could include a confidentiality agreement or an agreement to purchase assets of an existing unit from the franchisor, even if conditional. Accordingly, it is best practice to provide a disclosure document to a prospective franchisee prior to having the prospect sign any agreement that may be associated with or connected in some way with the franchise opportunity.

Section 5 also contains particulars pertaining to, among other things, the means for delivery of the disclosure document, the requirements for disclosure of material changes, what transactions are exempt from disclosure and, most importantly, the contents of the disclosure document. Section 5(4) of the Act may be the most all-encompassing of the Act's provisions. It provides as follows for the required contents of the 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.

Although the various items for disclosure are prescribed in the Regulations, these prescribed items are not exhaustive. Particular attention must be made to Subparagraph 5(4)(a) of the Act which provides for the disclosure of all "material facts" which is broadly defined to include any information about the business, operations, capital or control of the franchisor 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. It is this requirement for disclosure of all material facts that has led to some of the most significant franchise law decisions, which are discussed below, and as a result require that disclosure documents be particularized with information applicable to the proposed location of the franchised unit.

The disclosure document must also contain the franchisor's financial statements, which must be either audited or with a review engagement report. Financial statements prepared in another jurisdiction may be used provided that they have been prepared in accordance with generally accepted accounting principles which are *at least equivalent to* the audit or review engagement standards of the Canadian Institute of Chartered Accountants Handbook. Franchisors who have operated for less than one fiscal year are permitted to include an opening balance sheet in lieu of audited or review engagement financial statements.

An exemption from the requirement to disclose financial statements is available for large, experienced franchisors which meet the criteria prescribed in Paragraph 11 of the Regulations.

Section 5(4) of the Act also requires that a disclosure document contain copies of all proposed franchise agreements and other agreements relating to the franchise which a prospective franchisee may be required to sign. "Franchise agreement" is broadly defined to include any agreement between the franchisor or the franchisor's associate and the franchisee which relates to a franchise. As a result, the following, if they form part of the franchisor's requirements, need to be included in the disclosure document: sublease, general security agreement, personal guarantee and turn-key development agreement. As "other agreements relating to the franchise" are also part of the prescribed disclosure, a franchisor may also wish to include in its disclosure documents, agreements to be signed by a franchisee and a third party which could include equipment lease agreements, maintenance contracts and construction contracts.

Finally, the disclosure document must be certified as complete disclosure in accordance with the Act. In the case of a franchisor that is not incorporated, the certificate must be dated and

signed by the franchisor; if a franchisor is incorporated and has only one director or officer, the certificate must be signed by that director or officer; and in the case of a franchisor that is incorporated and has more than one officer or director, the certificate must be signed by at least two persons who are officers or directors. A dated and signed certificate is a mandatory requirement of the franchise legislation, not a mere formality. Failure to have a disclosure document properly certified has been held to entitle the franchisee to rescind the franchise agreement on the basis that no disclosure document was provided.[5] Franchisors that are incorporated must ensure that this Certificate is signed by one or more officers or directors, as the case may be, who are named as officers or directors in the disclosure document, and that it is signed in their personal capacity and not on behalf of the franchisor.

The Act also mandates formal delivery requirements for the disclosure document, which the Courts have not been hesitant to strictly enforce. A disclosure document must be one document, *delivered … as one document at one time* (Ss 5(3)) and the information in a disclosure document must be *accurately, clearly and concisely set out* (Ss 5(6)). Furthermore, as the Regulations require that certain of the information required to be disclosed must be set out together and in a certain place in the disclosure document, it is unlikely that an Ontario disclosure document, prepared based upon a pre-existing disclosure document from another jurisdiction would comply with the Act's requirements. In addition, unlike the franchise disclosure legislation in force in each of Alberta, New Brunswick[6] and Prince Edward Island[7] and the yet to be proclaimed Manitoba *Franchises Act*[8], the Act does not expressly permit the use of a "wrap-around" for the creation of an Ontario disclosure document.

4. The Rescission Remedy

If a franchisor fails to comply with the Act's disclosure requirements, a franchisee has the right to rescind the franchise agreement. Section 6 of the Act provides 2 separate, and seemingly distinct, time periods within which the franchisee can rescind. However, as discussed below, the interpretation by the Courts of the rescission remedy has blurred these 2 time periods.

The rescission remedy reads as follows:

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[5] *Hi Hotel Limited Partnership v. Holiday Hospitality Franchising* [2008] A. J. No. 892 (C.A.)

[6] *Franchises Act*, Chapter F-23.5 (herein, the "NB Act")

[7] *Franchises Act*, Chapter F-14.1 (herein, the "PEI Act")

[8] S.M. 2010, c. 13

> 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.
>
> (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.

Notice of rescission must be given in writing and delivered to the franchisor, personally, by registered mail, by fax or by any other prescribed method (to date no other delivery methods have been prescribed). Once faced with a notice of rescission, the franchisor is required to comply with the following obligations, set out in Section 6(6) of the Act, within 60 days of the effective date of 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).

This is certainly an onerous obligation imposed upon a franchisor. Although much has been written about what a franchisee could seek to claim on account of losses incurred, that discussion is beyond the scope of this paper. The amounts payable by the franchisor pursuant to (a) – (c) are more easily discernable.

Judicial decisions on rescission claims have made it clear that strict compliance with the disclosure requirements of the Act and the Regulations is required. If the deficiencies in the

disclosure document are so significant as to have prevented the franchisee from making an informed decision, there is a significant risk that the document provided by the franchisor will be deemed to not be a disclosure document required to be provided by the Act. As a result, the franchisee will be entitled to rescind its franchise agreement within 2 years of entering into the franchise agreement. In other words, provision by a franchisor of a document purporting to be a disclosure document will not restrict the franchisee to the 60-day rescission remedy under Section 6(1) of the Act.

Furthermore, disclosure provided to a prospective franchisee piecemeal over a period of time or one containing information not required by the Act or the Regulations to be provided for disclosure purposes, will be deemed not to meet the Act's requirements.

In *1490664 Ontario Ltd. v. Dig This Garden Retailers Ltd*.[9], the Court stated that the main purpose of the Act is the obligation imposed upon a franchisor to make full and accurate disclosure so that a prospective franchisee can make an informed decision about investing in the franchise opportunity.

In *Sovereignty Investment Holdings, Inc. v. 9127-6907 Quebec Inc*.[10], the Court identified four deficiencies in the disclosure document provided to the franchisee, out of the 19 deficiencies claimed by the franchisee, any one of which was fatal to a compliant disclosure document:

(a) failure to include financial statements in accordance with Subsection 5(4)(b) of the Regulations;

(b) failure to include a statement specifying the basis for earnings projections provided in the disclosure document;

(c) failure to provide disclosure in a single document at one time as required by Subsection 5(3) of the Act; and

(d) the absence of a signed certificate as required by Section 7 of the Regulations.

Failure to comply with any of these requirements, according to the Court, precluded a prospective franchisee from making an informed investment decision.

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[9] [2005] O.J. 3040 (herein, "Dig this Garden")
[10] [2008] O.J. No. 4450 (Ont SC) (herein, "Sovereignty Investment")

The Court further held, in *Sovereignty*, that the assignee of the franchisor's obligations under the franchise agreement was also liable for the original franchisor's failure to deliver a compliant disclosure document. As a result, the original franchisor and the purchaser of the franchise system were jointly and severally liable for the franchisor's post-rescission obligations under Subsection 6(6) of the Act. For that reason, third party purchasers of a franchisor's assets should ensure that their purchase agreement contains appropriate indemnities for any failure by the vendor franchisor to have provided proper disclosure to its franchisees.

The leading Ontario case on the interpretation of the "material facts" disclosure requirement is the Court of Appeal decision in *6792341 Canada Inc.* v. *Dollar It Limited*[11]*.* In that case, the franchisee attempted to rescind its franchise agreement pursuant to Section 6(2) of the Act and made application to the Superior Court for declaratory relief. The Court dismissed the application on the grounds that, as the franchisee had received a disclosure document, it was entitled only to the right of rescission under Section 6(1) of the Act.

On the franchisee's appeal to the Court of Appeal, the Court relied in part on the decision in *Hi Hotel* (see note 4 above) and held that the lack of a signed and dated Certificate of Disclosure was sufficient to establish that the franchisor failed to provide a disclosure document to the franchisee. However, the Court also discussed other "material" information missing from the disclosure document which was necessary for the franchisee to make an informed decision.

The Court, in its reasons, looked to the purpose and intent of the Act, being to protect the interests of franchisees and to permit a prospective franchisee to make an informed decision about whether to make the investment. The Court held that the provisions of Sections 6(1) and 6(2) must be read and interpreted broadly in light of the intended purposes of the Act and that to interpret those provisions strictly would "lead to absurdity". Taken together, the disclosure document deficiencies were so material that "the only reasonable conclusion is that the franchisor never provided the disclosure document within the meaning of Section 6(2)".

Among the deficiencies noted by the Court in *Dollar It,* the disclosure document provided by the respondent franchisor did not include:

(1) a signed and dated Certificate of disclosure;

(2) financial statements or an opening balance sheet;

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[11] (2009), 95 O.R. 3d 291 (CA) (herein, "Dollar It")

(3) a copy of the lease for the premises under which the franchisee was the subtenant;

(4) information on the franchisor's affiliate which was the tenant and sublandlord of the premises;

(5) prescribed information pertaining to the franchisor's advertising program; and

(6) a description of the exclusive territory to be granted and the franchisor's policy on proximity between franchisees.

In its decision, the Court acknowledged that whether disclosure is deficient is fact specific and each case would have to be reviewed based upon what information the disclosure document contained. Accordingly, it is not clear from the decision whether any of the noted deficiencies alone would have been sufficient to constitute a failure to provide disclosure within the meaning of the Act or whether the Court relied on the fact of a number of deficiencies. However, of note is the Court's determination that the failure to provide a copy of the lease for the premises at which the franchised business was to be operated as well as information regarding the franchisor's affiliate which was the tenant under the lease was a failure to disclose material facts.

The decision in *Dollar It* has been followed in a number of cases involving allegedly deficient disclosure. The uncertainty felt by franchise law practitioners as to the precise disclosure requirements under Section 5 of the Act and the interplay between Subsections 6(1) and (2) has now been all but eliminated. It is now evident that franchisors in Ontario must comply strictly with the disclosure requirements of the Act and ensure that all available material information is included in their disclosure documents. This includes information particular to the specific location at which the franchised business will be operated. A generic, "standard form" disclosure document will not suffice to protect a franchisor from the penalties imposed under the Act for non-compliance if, at the time that disclosure is made, location specific information was known by the franchisor.

5. Claim for Misrepresentation

In addition to the rescission remedy, Section 7 of the Act provides a franchisee with the right to sue if it suffers loss because of a misrepresentation contained in the disclosure document or if the franchisor fails to comply with section 5. It is arguable therefore, that if a franchisee misses the time period for rescission in Section 6, it can still seek damages for breach of the Section 5

disclosure obligation. The claim can be made against not only the franchisor but also against the franchisor's agent, the franchisor's broker, the franchisor's associate and any director or officer of the franchisor who signed the Certificate of disclosure. "[F]ranchisor's agent, "franchisor's broker" and "franchisor's associate" are all defined in the Act.

"Misrepresentation" is defined in the Act to include "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." A franchisee is deemed to rely on a misrepresentation in a disclosure document, (unless proven that the franchisee was aware of the misrepresentation and still proceeded to acquire the franchise) and, if there is a failure to comply with the Section 5 disclosure requirements, a franchisee is deemed to have relied on the information contained in the disclosure document that has been provided.

6. The Duty of Fair Dealing, Right of Association and Non-Waiver

The Act imposes significant other obligations upon the parties to a franchise agreement in addition to a franchisor's disclosure obligation, and provides remedies for breach of such obligations. Each of these provisions has been considered by the Courts in Ontario. The duty of fair dealing, the right of association and the non-waiver provisions of the Act are discussed below.

7. Duty of Fair Dealing

Section 3 of the Act imposes on each party a duty of fair dealing in its performance and enforcement and provides that "the duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards." This requirement has been interpreted generally to require that the franchisor enforce the franchise agreement absent any malice or ulterior purpose, and in a manner which takes into account the interests of the franchisee in the franchise relationship in addition to its own. More specifically, the obligation imposes limitations on the scope of discretion which the franchisor may employ in enforcing its strict contractual rights where such exercise negatively impacts the interests of the franchisee. The obligation has also been interpreted to require the franchisor to be transparent in its dealings with the franchisee where failure to do so may unfairly harm or prejudice the franchisee. The duty to act fairly applies equally to the franchisor and its franchisees[12] and a breach of this obligation

[12] See *Gerami v. Double Double Pizza Chicken Ltd.* [2005] O.J. No. 5252 and *Personal Services Coffee Corp. v. Beer*, (2005) 256 D.L.R. (4th) 466 (Ont. C.A.)

subjects the breaching party to a claim for damages pursuant to subsection 3(2) of the Act. The operation of section 3 of the Act will be illustrated in the caselaw referred to below.

Shelanu v. Print Three Franchising Corporation is one of the leading cases to consider the scope of the duty of fair dealing[13]. In that case, which addressed, *inter alia*, whether the franchisor had breached its statutory and common law duty of good faith by establishing a separate printing franchise named "Le Print Express" and by permitting the upstart franchises to operate in close proximity to the franchisee. The franchisor contended that Le Print Express was formed to service retail customers whereas the franchisee's stores purportedly targeted commercial clients.

The trial judge found a common law duty of good faith notwithstanding the application of the Act. In finding that the duty had been breached, he wrote:

> "Even though the Le Print Express franchises were directed at a specific segment of the industry, I am satisfied that they not only would, but did, take work and customers from existing Print Three franchises. As a consequence, in my view, the establishment of such an enterprise by the very person who owned and controlled the defendant was fundamentally at odds with the defendant's obligations, including the obligation to deal in good faith, to its franchisees."[14]

The *Shelanu* case was cited in *Katotikidis v. Mr. Submarine Ltd.* [15] in support of the proposition that a common law duty of good faith exists notwithstanding the statutory duty set out in the Act. In *Katotikidis*, a Mr. Submarine franchisee in Toronto's Eaton Centre failed, partially as a result of the closing of the Eaton's department store. Despite assurances that it would offer an alternative nearby location to the franchisee, the franchisor recanted and another franchisee opened the new location in competition with the existing franchisee's failing store.

Taliano J. of the Ontario Superior Court of Justice held that "by opening a new restaurant in unreasonably close competitive proximity to the plaintiffs and then awarding the restaurant to someone else, the defendant violated the implied duties of good faith and fair dealing contained in their franchise agreement and promotional materials and thereby betrayed the trust that epitomizes the relationship between a franchisor and franchisee."

As noted above, the duty of fair dealing requires franchisors to take the interests of the franchisee into account and to address these interests with transparency and integrity. In

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[13] *Shelanu Inc. v. Print Three Franchising Corporation* (2003), 64 O.R. 533 (C.A.) (herein, "Shelanu")
[14] See Shelanu, Note 13, *supra*, at paragraph 38.
[15] *Katokidis v. Mr. Submarine*, 2002 CanLII 49646 (Ont. S.C.J.)

Country Style Food Services v. 1304271 Ontario Ltd.[16] a franchisee alleged breach of the duty of good faith and fair dealing against a franchisor who failed to actively oppose a landlord whose redesign of a commercial development materially adversely affected the drive-through traffic flows and access to a proposed Country Style outlet. The Ontario Court of Appeal upheld the trial judge's findings that while the franchisor, who was on the head lease, had formally objected to the development, it had breached its duty of good faith by failing "to support the franchisee and it attempted to walk the fence between the franchisee and the landlord." The Court of Appeal concurred and commented that the franchisor took no legal steps to halt the development or shield the franchisee from the unilateral and arbitrary acts of the landlord, but instead asserted in its defence to the franchisee's counterclaim that the landlord's activities did not result in any damages to the franchisee.

The Courts will not apply this duty to require a franchisor to renew a franchise agreement where a renewal right is not provided for by the express terms of the written agreement between the parties[17]. However, the Courts have imposed the duty of fair dealing where a franchisor has interpreted the franchise agreement renewal provisions in order to avoid renewal of the franchise agreement by an existing franchisee.[18] In *Salah v. Timothy's Coffees,* the franchise agreement between the parties required the franchisor to renew the agreement if it successfully negotiated a new head lease for the location. The franchisor was unable to secure new lease terms for the existing location on the third floor of a mall but entered into head lease negotiations for a new location on the second floor. It actively withheld from the franchisee its plans to open the new location on the second floor and refused to communicate with the franchisee during the renewal process. The appeal court concurred with the findings of the trial judge that the franchisor had breached its duty of fair dealing by actively keeping the franchisee "from finding out what was going on with the lease" and by deliberately withholding critical information and not returning telephone calls.

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[16] *Country Style Food Services Inc. v 1304271 Ontario Ltd.* (2003), 32 B.L.R. (3d) 207, aff'd (2005), 7 BLR (4th) 171; 200 OAC 172.

[17] See *TDL Group Ltd. v. 1060284 Ontario Limited*, 2000 CanLII 22758 (Ont. S.C.J.), aff'd [2001] O.J. 3614 (Div. Ct); *530888 Ontario Ltd. v. Sobeys Inc.*, 2001 CanLII 28359, 12 B.L.R. (3d) 267 (Ont. S.C.J.); and Automobiles Jalbert Inc. v. BMW Canada Inc., [2006] J.Q. No.8803 (Q.C.A.).

[18] See *Salah v. Timothy's Coffees of the World Inc.* (2010), 65 B.L.R. (4th) 235 (Ont. S.C.J.), aff'd 2010 ONCA 673 (C.A.) (herein, "Salah")

In actions for breach of the duty of fair dealing, the Courts have seen fit to award general damages above and beyond a franchisee's monetary loss[19] and will award punitive damages in appropriate circumstances.[20]

8. Right of Association

Section 4 of the Act provides as follows:

> 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.

In summary, a franchisor may not interfere with a franchisee's right to communicate with one another, or to establish and be part of an association of franchisees. Breach of this section by a franchisor entitles an affected franchisee to a statutory right of action for damages.

In *405341 Ontario Limited v. Midas Canada Inc*.[21], Section 4 was interpreted to protect the franchisee's right to participate in a class action claim against its franchisor. In that case, the Courts considered the enforceability of certain provisions in the Midas franchise agreement requiring a general release from the franchisee as a condition to any assignment or renewal. The issue arose in the context of a class action proceeding alleging that Midas had breached its common law and statutory duties of good faith and fair dealing by outsourcing its product supply to a third party supplier. The delivery of the release would have had the effect of disqualifying the plaintiff from the class proceeding. The Court granted the relief sought partially on the basis

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[19] See Salah, Note 18, *supra*.
[20] See *Katokidis*, Note 15, *supra.*
[21] 2010 ONCA 478 (herein, "Midas").

that section 4(4) voids any provision in a franchise agreement which "purports" to interfere with or restrict the exercise of the right of association, including provisions which "have the effect of interfering or restricting the statutory right and not merely those which assert or profess an intention to do this." In other words, the fact that the requirement for a release arose in the context of an assignment by the franchisee of its franchise agreement and did not directly and expressly interfere with the right to participate in a class action did not prevent the Court from holding that the requirement in the franchise agreement for a release was void.

9. Rights Cannot be Waived

Section 11 of the Act provides as follows:

> *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 associate by or under this Act is void.*

This "anti-waiver" provision ensures that franchisees cannot intentionally or unknowingly compromise the rights and remedies available to them under the Act.[22] The anti-waiver provision renders void any attempt to contract out of the rights, obligations and requirements of the Act. A franchisor cannot, for example, enforce an agreement to dispense with its disclosure obligations and the franchisee's accompanying rescission rights. Nor can a franchisor bind a franchisee to ignore the franchisor's duty of fair dealing, or to agree not to associate with other franchisees. Finally, a franchisee cannot contract out of its statutory rights to damages arising from a franchisor's breach of its obligations to act in good faith, to permit association, and to comply with its disclosure obligations.

Despite the foregoing, the Courts will uphold a release of existing known claims given by a franchisee with the benefit of independent legal advice, as part of a negotiated settlement between the franchisor and the franchisee.[23] In the *Tutor Time* decision, the Courts upheld the public policy rationale which supported permitting parties to finally settle their disputes in an informed negotiation for fair consideration with the benefit of legal counsel.

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[22] See *Dig This Garden*, Note 9, *supra.*
[23] See *1518628 Ontario Inc. v. Tutor Time Learning Centre, LLC* 2006 CANLII 25276 (Ont. S.C.J.) (herein, "Tutor Time")

As discussed above in *Midas*[24], a release given as a condition to assignment or renewal of a franchise agreement is *prima facie* void pursuant to Section 11 and that provisions in a franchise agreement requiring such releases as conditions to the franchisor's consent to assignment or renewal are unenforceable. As a result of *Midas*, the longstanding practice of requiring a general release as a condition of renewal or assignment has been modified. Franchisors may request releases of matters which are not protected by section 11 (ie common law claims), but must be cautious in requiring any waivers or releases of statutory rights of the franchisee or statutory obligations of the franchisor, upon any assignment or renewal.

10. Preparation and Review of Franchise Disclosure Document

The preparation of a franchise disclosure document that complies with the Act (and with the franchise laws in force in Alberta, PEI and NB) is an increasingly complex undertaking which requires not only an exhaustive and current knowledge of the legislation but also very disciplined practices and procedures. The latter will ensure that all material facts and other required information are made available to the drafter and technical knowledge will ensure that the information is presented in the correct manner.

(a) Information Gathering

Typically, data is collected directly from the franchisor and its directors, officers and managers through the use of questionnaires which are tailored to solicit information specifically required from such individuals pursuant to the Act's regulations. In addition to the statutorily prescribed disclosures, the questionnaires must include general and specific inquiries about the existence of other facts which may be known by the franchisor's executives and which may, if known to the franchisee, impact negatively upon the franchisee's decision to purchase the franchise or the price it would be willing to pay for the franchise. Examples of such material facts may include decisions of the franchisor (whether or not implemented) to materially alter the brand image, product mix or trade dress of the franchise system at some time in the future; plans to expand, merge, acquire or divest some or all of the franchised business; plans to repatriate franchises to corporate or vice versa; decisions to expand into new channels of trade which may impact upon the traditional franchise delivery model; and settled, pending or threatened proceedings or lawsuits. Other types of information which require specific inquiry may include:

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[24] See Midas, *Supra*, Note .

- Impact of specific or proposed regulatory, market or local changes on the operation of the franchised business
- Background and risk factors relating to the nature of the franchised business
- Warranty, return, customer complaint and employee policies
- Requirement for the grant of security and personal guarantees
- Historical revenue data of individual franchisees

While the disclosure document is ultimately the franchisor's product, the quality of the questionnaire will influence the quality of the responses and therefore cannot be overlooked. Questionnaires should be supplemented with interviews in order to discern information specific to the particular franchise, and franchisor's counsel are advised to review all documentation pertaining to the franchisee recruitment process, such as sales and promotional materials, websites and application forms, in order to ensure that these documents are consistent with the information contained in the disclosure document.

(b) Sufficiency of Disclosure

As noted above, the Act requires that the franchise disclosure document be delivered as one document at one time[25] and include all information required by the Act and Regulations, including all prescribed information, material facts (as that term is defined in the Act), facts required by the regulations, financial statements, copies of all agreements relating to the franchise and the certificate of the directors or officers, in an accurate, clear and concise presentation. Piecemeal delivery of the constituent elements of the disclosure document is not permitted in Ontario[26] and failure to include all of the elements of the disclosure at one time may result in a finding that "no disclosure document" was provided within the meaning of the Act, exposing the franchisor to the two year rescission window. It is noteworthy that franchise legislation in PEI and Alberta[27] do provide that a disclosure document will be properly given if it is "substantially complete", although there is no clear judicial definition of the term. Manitoba's pending legislation states that a franchisor complies with its disclosure obligations if its

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[25] See *MAA Diners Inc. v. 3 for 1 Pizza & Wings (Canada) Inc.*, [2003] O.J. No. 430 and *Dig this Garden*, Note 9, *supra*.
[26] *Dig this Garden,* Note 9, *supra.*
[27] See section 2(4) of Alberta Regulation 240/95 and section 3(3) of the PEI Regulation Chapter F-14.1.

document "substantially complies" with the Act and "even if the disclosure document contains a technical irregularity or mistake not affecting the substance of the document"[28].

As described above, the Alberta Court of Appeal held in *Hi Hotel* that failure to sign and date the required certificate attesting to the accuracy and completeness of the disclosure document invalidated the disclosure document and was tantamount to no disclosure, affording the franchisee the right to rescind the franchise agreement within the two year rescission period.[29]

This judicial trend is reflected in Ontario, where circumstances in which a disclosure document though given at one time and on time but which lacked certain critical material information, including the signed certificate, details of the franchisor's associates, required financial disclosures, disclosures relating to the advertising fund, and policies respecting exclusive territory and rebates, was found not to be a "disclosure document" within the meaning of the Act.[30] The practical effect of the judicial activism in Ontario, as discussed above, is to raise the standard of care of franchise lawyers in their drafting of disclosure documents and to ensure that franchisors are scrutinizing their disclosure procedures to ensure that no critical issues are overlooked.

In practice, a disclosure document prepared for use in the U.S. is not suitable for use in Ontario.[31] While much of the information from the U.S. FDD can be imported with little and in some cases no modification, practice standards dictate that an Ontario (or provincially) specific disclosure document should be drafted.[32] As earlier noted, the Alberta, NB, PEI and Manitoba statutes expressly permit the use of a "wrap around" or supplementary addendum to a disclosure document of another jurisdiction. The addendum must contain all information and statements which are specifically required by the province's legislation.

Franchisors are usually advised to make voluntary disclosure in provinces without disclosure laws in order to ensure fairness amongst franchisees and to comply with the Code of Ethics of the Canadian Franchise Association. The franchisor would normally not provide a signed certificate as it would in the disclosure provinces, and is advised to obtain an acknowledgement and release from the prospective franchisee agreeing that the disclosure is voluntary and

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[28] See section 5(10) of the *Franchises Act* (Manitoba).
[29] See *Hi Hotel*, Note 5, *supra*.
[30] See *Dollar It*, Note 11, *supra*. See also Sovereignty Investment, Note 10, *supra.*
[31] Section 5(6) of the Act requires all information in a FDD or statement of material change to be accurately, clearly and concisely set out.
[32] See, for example, Tutor Time, Note 23, supra, at 72 and 73.

releasing the franchisor from any claims resulting from discrepancies between information or assumptions in the FDD and the market realities of the prospect's home province.

11. Method of delivery and receipt

(a) Delivery

The Act requires that the disclosure document be delivered in person, by registered mail, or by other prescribed means. No other means have been prescribed. The Alberta Act simply requires that the franchisor "give" the document to the prospective franchisee.

The PEI Act's regulations permit, in addition to personal and mail delivery, electronic delivery and delivery by courier provided a receipt is given. Electronic disclosure may be used provided the document is in a single integrated document or file, has no extraneous content beyond what is required by law, has no links to or from external documents or content, is capable of being stored, retrieved and printed, conforms to legal form and content requirements, is recorded by the franchisor and is acknowledged by the franchisee in writing. The NB Act also permits delivery by prepaid courier and delivery by electronic means on terms similar to the PEI legislation.

(b) Receipt

The various provincial franchise statutes require that the disclosure document be provided and the prospective franchisee receive the document not less than 14 days prior to the execution of any agreement or the receipt of any payment. Although not expressly required by the legislation, it is strongly recommended that the franchisor obtain a signed and dated receipt from the franchisee acknowledging that it has received a complete copy of the relevant disclosure document together with all attachments. In addition, the franchisor should retain an exact duplicate copy of the disclosure provided for evidence purposes if needed in the future.

12. Statement of material change

A franchisor must deliver to a prospective franchisee a written statement detailing any material change as soon as possible after such change and before the earlier of the signing of any agreement relating to the franchise and the payment of any consideration in relation to the franchise. 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;"
>
> [emphasis mine]

It is important to note that only adverse material changes are worthy of supplementary disclosure and that changes which benefit the franchisee (such as amendments to the franchise agreement which do not affect the balance of the document) do not need to be disclosed.

The legislation does not prescribe that the franchisee is entitled to an additional 14 days from the date of the statement to contemplate the material changes. However, the prospective franchisee should be given reasonably sufficient time to consider the changes and consult with their professional advisors as to the effects of the new information.

The format of the material change statement is not prescribed. The statement should at a minimum refer to the original disclosure document and its headings and subheadings in order to meet the Act's requirements of accuracy, clarity and conciseness. The statement should be certified in the same manner as the original disclosure document and should be delivered by means permitted by the applicable regulations.

13. Correcting a disclosure document after the fact

Where a franchisor or its counsel discover, prior to the execution of a franchise agreement, that a deficient disclosure document has been provided to a prospective franchisee, it may correct the disclosure by immediately retracting the original disclosure and reissuing a fresh (and corrected) disclosure document with a new 14-day waiting period.

The real issue arises when a franchisor discovers a material deficiency after the franchise agreement is entered into. The franchisor is faced with a true conundrum in that failure to correct the disclosure leaves it with a potentially disastrous liability, albeit limited by the appropriate rescission and statutory limitations periods, respectively. Admission of the defect (howsoever minor) and the request for correction may precipitate a demand for consideration by the franchisee (or even worse, the threat of a claim) which may prove disproportionate to the gravity of the deficiency.

It has been proposed[33] that a franchisor could deliver corrected disclosure accompanied by an offer to the franchisee to rescind the franchise agreement. If the franchisee acquiesces, a replacement franchise agreement could be entered into, at the expiry of the 14-day disclosure period, on the same terms as the original contracts. This would "novate" the agreement, there would arguably be no original "grant" left to rescind and limiting section 7 damages under the Act. Consideration for the novation and the new "grant" would be the discharge of the obligations under the existing contract.

14. Key Differences between the provincial statutes

While the provincial franchise disclosure statutes of Ontario, Alberta, PEI and NB share most of their basic elements, there are certain significant differences that highlight the innovations in the newer statutes and some of the shortcomings of the Act. It is important when drafting disclosure documents for different provinces or when creating a national disclosure document to be acutely aware of these differences and to ensure that the standard of disclosure is met for each province in which the franchisor recruits franchisees. Without intending to be exhaustive, some of the principal differences are set out below:

(a) Exclusion of wholesale arrangements

The Alberta, PEI and NB Acts specifically exclude arrangements where the distributor is required to purchase goods but which are at *bona fide* wholesale prices. The Act does not provide for this. Accordingly, arrangements which involve the purchase of goods, even for *bona fide* wholesale prices, for sale in connection with a trademark where the vendor exercises some control over the purchaser or provides some measure of assistance, must be carefully tailored to avoid arguments that they constitute franchise relationships.

(b) Agreements relating to the franchise

The Act prohibits the entering into of any agreement relating to the franchise prior to the expiry of the 14-day waiting period. The PEI, Alberta and NB Acts permit the execution of confidentiality and site selection agreements at any time. The Alberta Act also permits the execution of fully refundable deposit agreements at the outset of the franchise relationship and prior to the expiry of the 14 day waiting period. This omission from the Act prevents a franchisor from obtaining a deposit at the outset of the relationship and perhaps more onerously, from

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[33] Trebilcock, Arthur, "Draft Disclosure Documents: Some Issues and Tips", 5th Annual Franchise Law Conference, Ontario Bar Association, September 21, 2005, pp.15-16.

protecting confidential disclosures in its FDD by means of a binding non-disclosure agreement. This is somewhat (although unsatisfactorily) remedied by the practice of drafting a notice on the covering page of the FDD indicating that it is a confidential document.

(c) Substantial completeness

As indicated above, the Alberta and PEI legislation provide that a substantially complete disclosure document is deemed to satisfy the requirements of the respective statutes. As we have earlier noted, the Act requires strict compliance with the disclosure requirements to avoid the possibility of a rescission argument under section 6(2) of the Act.

(d) Delivery

The NB Act and PEI Act permit delivery by courier and electronic delivery of the disclosure document, subject to certain conditions to ensure that the electronic documents are functionally equivalent to the paper versions. The PEI Act also expressly provides that the FDD may be delivered in machine-readable media and the NB Act expressly permits delivery by fax.

(e) Wrap-around

The PEI, NB and Alberta Acts permit the use of a disclosure document prepared to comply with the requirements of another jurisdiction (eg. a U.S. FDD) provided that supplementary information (commonly known as a wrap-around) is included to comply with the requirements of the applicable Act.

(f) Application to the Crown

The PEI Act exempts the government and its agents (the "Crown") in its entirety, whereas the Ontario Act exempts service contracts or franchise-like arrangements with the Crown. Alberta and Manitoba have no exemption for the Crown. Section 2(1) of the NB Act expressly binds the Crown.

(g) Background of directors and officers

The Alberta Act and PEI Act limit disclosure to the business background of directors, general partners and officers of the franchisor who will have day to day management responsibilities relating to the franchise while the Act requires disclosure of <u>all</u> directors and officers, irrespective of a director or officer's role in the management and operation of the franchisor or the franchise system.

(h) Time limits on disclosure of past administrative and civil actions

The PEI Act and NB Act limit disclosure of liabilities relating to misrepresentation, unfair or deceptive practices or violation of law regulating franchising (including a failure to provide proper disclosure) to the past 10 and 5 years preceding the date of the FDD, respectively. The analogous disclosures required under the Ontario and Alberta Act look back indefinitely.

(i) Guarantees and security interests

The PEI Act requires disclosure of the franchisor's requirements relating to guarantees and security interests to be provided by franchisees.

(j) Operations Manual

The NB Act requires disclosure of the table of contents of each operations manual used in the system or a statement of the location in New Brunswick where the manuals may be inspected.

(k) Internet and distance sales

The NB Act further requires the disclosure of the franchisor's policies respecting internet and distance sales. With the growth of ecommerce and the possibility of encroachment on traditional sales channels such as retail franchises, the addition of this disclosure is an important development.

(l) Dispute resolution

The NB Act contains a dispute resolution procedure whereby any party to the franchise agreement may deliver a notice to the other party setting out the dispute. The parties have 15 days within which to seek to resolve the dispute. After the expiry of such period, either party may deliver a notice to mediate the dispute. Mediation procedures are prescribed in a separate regulation.

There exist other differences and discrepancies between the various statutes and the reader is encouraged to review the various Acts and their regulations in detail to gain a comprehensive appreciation of these distinctions.

15. Conclusion

It is clear from the Courts' decisions that the Act will be broadly interpreted to ensure that the principles and purpose of franchise legislation will be met. The opportunity to level the playing

field and to remedy the apparent imbalance of power in the franchisor-franchisee relationship is being met by the Courts through a strict enforcement of the key provisions of the Act: the obligation placed upon franchisors to provide disclosure to prospective franchisees, the duty of fair dealing imposed on parties to a franchise agreement, the right of franchisees to associate and the bar against franchisees waiving rights granted to them under the Act. Whether or not one agrees with the extent to which the Courts have gone in their interpretation of these key provisions, the reality is that franchise legislation is a part of the franchise landscape and a key element for those wishing to expand their businesses through franchising.