

FRANCHISE LAW PART 3

Fatal Flaws in Disclosure Documents



If you are currently franchising your business or thinking about it, it is essential to consult a lawyer familiar with franchise law to prepare a proper disclosure document or to verify that your disclosure document is not fatally flawed.

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In previous issues we have described the situation of Mr. and Mrs. Singh, who own the franchisor SHD Inc., which franchises five “Singh’s Healthy Diner” locations in Ontario. One location is operated by Mr. Howard, who signed a franchise agreement 23 months ago. Through his lawyer, Mr. Howard claims that he did not receive the disclosure document he was entitled to receive under Ontario’s franchise law, the Arthur Wishart Act (“the Act”) and that he is rescinding the agreement. The Singhs maintain they *did* provide Mr. Howard with a disclosure document. However, they had omitted one requirement: their signatures on the certificate of disclosure.

Under Section 6 of the Act, if a franchisor does *not* provide a disclosure document, the franchisee is entitled to rescind the franchise agreement within *two years* of signing it. If the disclosure document is provided, but it is found to be deficient, the franchisee can rescind the franchise agreement only within *60 days* of signing it. After being served with a notice of rescission, the franchisor is obligated under the Act to refund to the franchisee all monies paid to it, buy back from the franchisee all inventory and equipment, and compensate the franchisee for *any* losses incurred in acquiring, setting up or operating the franchise.

In our fictitious example, the Singhs believe that since they provided a disclosure document, and since Mr. Howard signed his franchise agreement 23 months ago, he cannot rescind the franchise agreement, as the 60-day period for rescission noted above has passed. However, Mr. Howard’s position is that the absence of a signed certificate was such a material deficiency that he did not actually receive a disclosure document. Therefore, Mr. Howard claims that the two-year rescission period applies, rather than the 60-day rescission period. The courts have tended to agree with Mr. Howard.

In *Sovereignty Investment Holdings Inc. v. 9127-6907 Quebec Inc.*, the applicant argued that there were 19 alleged deficiencies with the disclosure document it received. The main issue before the court was whether any of the deficiencies were sufficiently material to enable the court to conclude that the franchisor failed to deliver a disclosure document as required under the Act. The Court found that there were four such fatal deficiencies:

1. No financial statements
2. No statement specifying the basis for the earnings projections and the assumptions underlying these projections
3. The disclosure document was not a single document delivered at one time
4. No signed certificate

The Court concluded that the franchisor failed to provide a disclosure document. Equally important, the court stated that each deficiency *on its own* is fatal to the assertion that the franchisor delivered a disclosure document. Consequently, the two-year rescission period applied in this case and the franchisor was liable to the franchisee for an amount exceeding \$1 million.

If you are currently franchising your business or thinking about it, it is essential to consult a lawyer familiar with franchise law to prepare a proper disclosure document or to verify that your disclosure document is not fatally flawed. Not doing so can prove very costly. At Lawrences, we help many franchisors navigate the often choppy waters of franchising a business, avoiding the rocks on which some businesses can founder.



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