

FRANCHISE LAW PART 2

What is a Franchise Disclosure Document?

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In Part 1 of this series on franchise law, we described Mr. and Mrs. Singh's diner that offers customizable, affordable, healthy food in a trendy setting. The Singhs have now successfully tested their concept at several locations, registered a trade-mark, and incorporated a company ("SHD Inc."), of which they are both directors. They now want to franchise their business and have been told they need a disclosure document.

What is a Disclosure Document?

In Ontario, the *Arthur Wishart Act* (the "Act") requires franchisors to give prospective franchisees a disclosure document—a significant amount of written, pre-sale information about the franchisor and its system. Disclosure documents often run well over 100 pages. If they turn out to be deficient (more about that in the next article), the franchisor and others face serious repercussions. Franchise laws are unique, complicated and fraught with danger for those unfamiliar with the requirements of the Act, or how courts have interpreted it.

What Must a Disclosure Document Contain?

In Ontario, a disclosure document must be accurate, clear and concise, and contain:

- copies of all proposed franchise agreements and other agreements relating to the franchise.
- financial statements as prescribed in the regulation made under the Act.
- all material facts, including facts as prescribed in the regulation.
- prescribed statements to assist a prospective franchisee to make an informed investment decision.
- other information and copies of documents as prescribed.
- signature(s) of a director or officer.

A "material fact" is any information about the business operations, capital and control of the franchisor or the franchise system that would reasonably be expected to have a significant effect on the value or price of the franchise, or the decision to purchase the franchise. Note that the list of material facts set out in the regulation to the Act is not exhaustive. All too often, franchisors do not go beyond the material facts listed in the regulation when preparing disclosure documents and may end up omitting something of importance.



The disclosure document must be delivered to the franchisee at least 14 days before the franchisee signs any agreement relating to the franchise or the payment of any moneys to the franchisor. Also, you cannot provide information to a prospective franchisee in piecemeal fashion: the disclosure document must be one document, delivered at one time.

Why Should We Care?

If SHD Inc. does not comply with the Act's disclosure requirements, or if it discloses information that turns out to be untrue or misleading, it faces serious legal and financial repercussions, including being sued for damages. Further, a franchisee has the right under the Act to rescind (i.e. cancel) the franchise agreement in certain circumstances. If this happens, the franchisor would have 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. Worse yet, any director of the franchisor who signed the disclosure document, such as the Singhs in our example, would be personally accountable to the franchisee, meaning that their personal assets would be at risk.

Given the detailed and technical disclosure requirements of the Act and the risk of serious financial repercussions for the company and its directors personally, the Singhs should consult an experienced franchise lawyer to help them prepare their disclosure document and navigate the complex, often poorly understood, legal aspects of franchise law in Ontario.



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