



THE FIVE TOP FRANCHISE DISCLOSURE DEFICIENCIES

FOR LAWYERS ADVISING FRANCHISORS AND FRANCHISEES

Prepared by Law Works PC/LC for informational purposes, July 2022.

The information contained in this e-book is general in nature and based on the law as of July 2022. It is not intended to, and does not constitute, legal advice. Each situation requires specific legal analysis. Please consult with a competent franchise lawyer about your case.

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THE IMPACT OF RECENT COURT OF APPEAL DECISIONS ON FRANCHISE DISCLOSURE LAW

In the past year, there have been major developments in franchise court cases impacting disclosure obligations in provinces across Canada where franchises are regulated (Ontario, British Columbia, Alberta, Manitoba, New Brunswick, and PEI). Three important Court of Appeal of Ontario decisions are:

1. *2619506 Ontario Inc. v. 2082100 Ontario Inc.*
2. *2021 ONCA 702; 2611707 Ontario Inc. v. Freshly Squeezed Franchise, 2022 ONCA 437; and*
3. *2483038 Ontario Inc. v. 2082100 Ontario Inc., 2022 ONCA 45*

Lawyers advising franchisors or franchisees should take note of a recent trio of Court of Appeal decisions.



The Court of Appeal for Ontario solidified and further developed franchise rescission grounds in the decisions that:

- upheld rescissions in favour of franchisees based on defective franchise disclosure documents (FDDs);
- confirmed established rescission grounds;
- expanded the elements that must be contained in an FDD for it to be legally valid, and
- expanded the list of who is liable to compensate the franchisee for rescission.

WHAT CONSTITUTES A VALID FRANCHISE DISCLOSURE DOCUMENT?

A franchisor is required to provide a valid Franchise Disclosure Document (FDD) to prospective franchisees 14 days before they sign any contractual commitment or pay any money to the franchisor. It must contain all fundamental components prescribed by franchise legislation and all material facts.

If an FDD is missing key information or documents, franchisees may have a right to cancel (rescind) the franchise purchase with compensation.

All required information and documents must be disclosed to prospective franchisees in one document, at one time.

A valid FDD must contain all these fundamental components:

- signed franchisor's certificate;
- full financial statements for the most recent year-end, in accordance with generally accepted review-engagement accounting standards;
- copies of all agreements the franchisees are required to sign;
- all material facts about the franchisor, the franchise system and the location, and
- all other prescribed information (setup costs, franchisees lists, including terminated franchisees, etc.).

ADVISING FRANCHISORS: THE RISKS OF NON-COMPLIANCE

There are potentially devastating financial and reputational costs for franchisors, their officers and directors if one or more franchisees makes a rescission claim.

Confirm your client's FDD complies with recent developments in disclosure law. Ensure that your client's FDD meets at least the five key elements outlined in this e-book (in addition to the many other legal requirements that an FDD must meet).

Legal counsel should take proactive steps with franchisors, their officers and directors against potential severe financial and reputational liabilities.



A non-compliant FDD can put franchisors at risk of a successful rescission claim that can result in:

- court awards that can reach hundreds of thousands of dollars of liability per franchisee;
- significant harm to the reputation and goodwill of the franchisor and the franchise system, and
- reputational harm to other franchisees in the system.

ADVISING FRANCHISEES: THE GROUNDS FOR A RESCISSION CLAIM

There may be potent grounds for franchisees to seek rescission if their business purchase has turned out to be financially or operationally challenging, and they are still within the statutory limitation period.

It is important to review all information with your client about the system, financials, operations, and location, which may be considered material fact; and whether that information was disclosed in the FDD.

Franchisees are subject to strict limitation periods for making a rescission claim.



Franchisees can deliver a notice of rescission in two circumstances:

- within 60 days of receipt of a Franchise Disclosure Document (FDD) if it is deficient in any way, or if it was not delivered within the required time, and
- within two years of the date of the Franchise Agreement if no FDD is delivered, or if the FDD is materially deficient.

COMMON DISCLOSURE DEFICIENCIES

This section of the e-book summarizes areas of non-compliance that invalidate a Franchise Disclosure Document (FDD) based on Canadian courts' rulings.

A court can rule an FDD is null or void if it is missing a key component.



These are the five key grounds that can nullify an FDD:

1. failure to include a Franchisor's Certificate;
2. failure to include Financial Statements;
3. failure to provide the FDD in one document, at one time;
4. failure to disclose “material facts” about the lease and location, where applicable, and
5. failure to disclose “material facts” about existing store revenues on a resale, where applicable.

1. FRANCHISOR'S CERTIFICATE

The certificate page of the Franchise Disclosure Document (FDD) must be signed by an officer or director of the franchisor (if there is more than one, then at least two officers or directors) to certify that it contains no untrue information, representations or statements, and includes every material fact, financial statement, and other information required by franchise legislation.

Valid FDDs must be certified by an officer or director of the franchisor.

The following are the types of deficiencies in a Franchisor's Certificate that courts have ruled nullify an FDD:

- **certificate was missing from the FDD** (*Sovereignty Investment Holdings Inc. v. 9127-6907 Quebec Inc.*, 2008);
- **certificate was not signed by at least two officers or directors** (*Mendoza. v. Active Tire and Auto Inc.*, 2017);
- **someone else signed the certificate on behalf of the franchisor** (*New Vision Renaissance MX Ltd. v. The Symposium Café Inc.*, 2020), and
- **certificate was unsigned** (*Hi Hotel Limited Partnership v. Holiday Hospitality Franchising Inc.*, 2008; 2483038 Ontario Inc. v. 2082100 Ontario Inc., 2020).

2. FINANCIAL STATEMENTS

The Franchise Disclosure Document (FDD) must include financial statements for the most recent fiscal year-end of the franchisor. The financial statements must be prepared at least on a review-engagement basis. They must also contain all critical information about assets (e.g., accounts receivable) and liabilities (e.g., customer deposits).

Valid financial statements must allow prospective franchisees to assess the financial health of the franchise system before they sign a franchise agreement.

The following are the types of deficiencies in the financial statements that courts have ruled nullify an FDD:

- **stale-dated financial statements** (*Mendoza v Active Tire & Auto Inc.*, 2017);
- **failure to include any financial statements** (*Sovereignty Investment Holdings Inc.*, v. 9127-6907 Quebec Inc., 2008);
- **failure to comply with audit or review-engagement standards** (*Giroux et al. v. 1073355 Ont. Ltd. et al.*, 2018), and
- **failure to include notes to the financial statements discussing the financial health of the franchise system** (*2611707 Ontario Inc.*, et al. v. *Freshly Squeezed Franchise*, 2022; *2619506 Ontario Inc. v. 2082100 Ontario Inc.*, 2021).

3. PIECEMEAL DISCLOSURE

Franchisors must deliver the Franchise Disclosure Document (FDD) to prospective franchisees in one document, at one time.

The FDD may be nullified if it was fragmented over time, in piecemeal.

The following are example of piecemeal disclosure that the courts have ruled nullify an FDD:

- disclosure of information over several months instead of in one document, at one time (*Mendoza v. Active Tire & Auto Inc.*, 2017);
- delivery of amended schedules and a sublease at a date later than the delivery of the FDD (*New Vision Renaissance MX Ltd. V. The Symposium Café Inc.*, 2020), and
- documentation provided to the franchisees was not collected in a single document and was delivered at the same time (*Sovereignty Investment Holdings, Inc. v. 9127-6907, Quebec Inc.*, 2008).

4. MATERIAL FACTS ABOUT THE LEASE AND THE LOCATION

Under franchise legislation, a “material fact” includes a wide array of information about the business and capital of the franchisor and its associates, as well as the franchise system, that would reasonably be expected to have a significant effect on the value of the franchise or the franchisee’s decision to buy it.

A Franchise Disclosure Document (FDD) must contain site-specific information. For retail locations, where a lease exists or is contemplated, the material facts include information about the lease, the location and lease obligations, where applicable.

A valid FDD must contain the lease and related documents (if a lease exists at the time).



The following are examples of failure to disclose material facts about the lease that the courts have ruled nullify an FDD:

- **failure to disclose a negotiated lease agreement or its terms** (*2611707 Ontario Inc. v. Freshly Squeezed Franchise*, 2022);
- **failure to disclose a lease agreement where the franchise agreement does not allow the franchisees to back out of the lease** (*2611707 Ontario Inc. v. Freshly Squeezed Franchise*, 2022);
- **failure to disclose that the location is an untested retail concept, first non-mall location, in the system** (*2611707 Ontario Inc. v. Freshly Squeezed Franchise*, 2022), and
- **not sharing the head lease and associated costs with the franchisees** (*6792341 Canada Inc. v. Dollar It Limited*, 2009; *2364562 Ontario Ltd. v. Yogurtworld Enterprises Inc.* 2021).

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5. MATERIAL FACTS ABOUT STORE REVENUES ON A RESALE

A Franchise Disclosure Document (FDD) must contain all other material facts about the franchisor, the franchise system, and the specific business. If the franchise to be sold is an existing business, material facts include the sales revenue history of the business.

Prior store sales constitute critical information for prospective franchisees when a franchise location is being resold.

The financial history of an existing business on a resale may be considered a “material fact” that must be included in the FDD.

The following are examples of failure to disclose the financial history of a business that the courts have ruled nullify an FDD:

- failure to disclose historical sales revenues for the location under the prior franchisees (*Giroux et al. v. 1073355 Ontario Ltd. et al.*, 2018), and
- failure to disclose store sales (*2619506 Ontario Inc. v. 2082100 Ontario Inc.*, 2021).

WHAT IS THE POTENTIAL OUTCOME OF A RESCISSION DECISION?

If the court decides a Franchise Disclosure Document (FDD) is materially non-compliant, franchisees may be entitled to significant compensation, in addition to a rescission of the purchase and all franchise-related agreements.

A franchisor can be liable for compensating its franchisees for their entire investment and losses in setting up and operating their franchise businesses.

A rescission can allow franchisees to exit a franchise system with a full refund of their investment and losses.

Canadian franchisees have been awarded compensation for the following costs in rescission decisions:

- **cost of building the location** (even if paid to third party contractors);
- **cost of all equipment** (even if paid to third party vendors);
- **future liabilities to creditors** (such as the remaining lease, loans, equipment leases);
- **all franchise-related payments** (franchise fee, royalties, etc.);
- **lease payments made to franchisors;**
- **operating losses, and**
- **franchisee principals' foregone salaries.**

ABOUT LAW WORKS

We are a franchise, commercial and real estate dispute resolution boutique law firm in Ontario and British Columbia. For over two decades, Ben Hanuka has represented Canadian franchisors, master franchisees, multi-unit franchisees and local single unit franchisees, as well as professionals, entrepreneurs and real estate investors, in a wide range of franchise, corporate/commercial, real estate and negligence disputes.

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- **Our Unique Skill Set:**

We have combined substantive expertise as courtroom and arbitration advocates. We are also savvy advisors around the boardroom table in all areas of franchise, real estate and corporate/commercial disputes.

- **Our Boutique Size and National Presence:**

We are a small specialty firm, yet we advise and represent parties from British Columbia to Ontario. We are in tune with the business and legal cultures in each province.

- **Arbitrations and Mediations:**

Ben has extensive training and qualifications to act as an arbitrator in franchise disputes. Having represented franchisors and franchisees in numerous cases, he understands both sides of the dispute and can act as an impartial arbitrator or mediator.

A SAMPLE OF OUR WORK REPRESENTING FRANCHISORS

2483038 Ontario Inc. v. 2082100 Ontario Inc., 2020 and 2022

Law Works defended the franchisor against a rescission claim brought by a franchisee.

[Court of Appeal Decision](#)

2214416 Ontario Inc. v. Peel Standard Condominium Corporation No. 937 (Brisdale Plaza Inc.), 2019

Law Works represented a franchisor that was a unit owner in a commercial condominium shopping center in a dispute about its rights to exclusive use of a restaurant.

[Court of Appeal Decision](#)

Kanda Franchising Inc. and Kanda Franchising Leaseholds Inc. v. 1795517 Ontario Inc., 2017

Law Works represented the franchisor in a dispute about the termination of a franchised location where the matter was heard in court over whether the case should proceed by way of arbitration, and over the appointment of an arbitrator.

[Court Decision](#)

1901709 Ontario Inc. et al. v. Dakin News Systems Inc., 2022

Law Works defended the franchisor in a trial over whether the franchisor was entitled to a resale disclosure exemption against a rescission claim brought by a franchisee.

[Court Decision](#)

A SAMPLE OF LEADING COURT DECISIONS WHERE WE REPRESENTED FRANCHISEES

Mendoza v. Active Tire & Auto Inc. (2017)

Law Works represented the franchisee in the Ontario Superior Court and on appeal in the Court of Appeal in a rescission claim based on stale-dated financial statements and missing signatures of the franchisor's officers and directors. The case is considered one of the leading franchise court decisions.

[Court of Appeal Decision](#)

Sirianni v. Country Style (2012)

Ben Hanuka represented the franchisees in one of the few trial decisions on record that found bad faith against the franchisor involving a renewal of a franchise agreement and head lease.

[Trial Decision](#)

Al-Harazi v. Quiznos Canada Restaurant Corporation (2007)

Ben Hanuka was lead counsel representing a group of approximately 200 franchisees in a class action against Quiznos after they signed a franchise agreement but never received locations for their restaurants. This was the first Ontario franchise disclosure class action. It resulted in a settlement of partial refunds of the franchise fee to different groups of the class members.

[Court Decision](#)

1518628 Ontario Inc. v. Tutor Time Learning Centres, LLC (2006)

Ben Hanuka represented the franchisee against a US franchisor in a case involving material facts and releases. The decision is among the most influential Ontario court decisions to date on the issue of releases and waivers of statutory franchise rights.

[Court Decision](#)



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