Don’t Become a Statistic: Accidental Franchises and Other Franchise Accidents

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Over the past several years, the Law Society has seen a material increase in the number of claims against franchise practitioners on both sides of the bar: franchisor lawyers being sued for problems with the disclosure documents they have helped prepare, and how and when they were delivered; and franchisee lawyers being sued for having missed those mistakes (or the time in which to act on them) and thus causing their clients to lose their statutory remedies.

Two broad factors that have been fueling this trend of increasing liability are the proliferation of franchising as a business model and the growing inclination of our courts to provide relief to franchisees, and thus to hold franchisors (often strictly) liable for their failures to comply with applicable law.

Not surprisingly given this recent activity, the advice provided by lawyers in this area has come under increased scrutiny and, again not surprisingly, lawyers are increasingly being made to share their clients’ pain.

The Act

Ontario franchisors' and franchisees' rights and relationships are governed by the *Arthur Wishart Act (Franchise Disclosure)*, 2000¹ (the "Act") and the regulations² (the "Regulations") made thereunder. While the Act and Regulations have only been in force for a relatively short period

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¹ S.O. 2000, c.3, as amended.
² Primarily the General Regulation, O. Reg. 581/00, as amended.
of time, their impact on the day-to-day dealings of commercial parties and their counsel has been profound. Moreover, as the use of franchising as a business model has spread, so too has the interest of Canada's provincial legislatures in regulating this area of law and practice. In addition to Ontario, similar statutes now exist in the provinces of Alberta, Prince Edward Island, New Brunswick and, most recently, Manitoba.

However, unlike certain other jurisdictions, including the United States, no Canadian province has tasked a particular agency or ministry with the oversight and enforcement of its respective franchise legislation. Accordingly, compliance is enforced by the parties against one another by resort to the remedies set forth in each enactment, as described below. This makes the role of the franchise lawyer all the more critical to the compliance and enforcement process, and has come to shine an even brighter spotlight on his or her actions and mistakes.

The Accidental Franchise

One of the most difficult aspects of the Act for lawyers to deal with is its very broad definition of "franchise", and hence the Act's application. Under subsection 1(1) of the Act, the term "franchise" is defined as follows:

"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

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3 *Franchises Act*, R.S.A. 2000, c. F-23 (the "Alberta Act").
5 *Franchises Act*, S.N.B. 2007, c. F-23.5 (the "New Brunswick Act").
7 Prior to 1995, the Alberta Securities Commission had jurisdiction over franchising in that province.
payments, to the franchisor, or the franchisor's associate,\(^8\) in the course of operating the business or as a condition of acquiring the franchise or commencing operations [the "Payment Requirement"] 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 [the "Trade-mark Requirement"], and

ii. the franchisor or the franchisor's associate exercises significant control over, or offer significant assistance in, the franchisee's method of operation including building design and furnishings, locations, business organization, marketing techniques or training [the "Control/Assistance Requirement"] [.]

This is known as the "business method" or "business format" definition of franchising, and it captures what is commonly understood as a franchise by most people.\(^9\)

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\(^8\) A "franchisor's associate" is defined in subsection 1(1) of the Act as a person (a) who directly or indirectly (i) controls or is controlled by the franchisor, or (ii) is controlled by another person who also controls, directly or indirectly, the franchisor, and (b) who (iii) is directly involved in the grant of the franchise (either by being involved in reviewing or approving the franchise grant or by making representations to the prospective franchisee on behalf of the franchisor for the purpose of granting, marketing or otherwise offering to grant the franchise), or (iv) exercises significant operational control over the franchisee and to whom the franchisee has a continuing financial obligation in respect of the franchise.

\(^9\) In addition, subsection 1(1) of the Act contains an alternative definition of "franchise", commonly known as the "business opportunities" definition, in which the same Payment Requirement is present, but instead of the Trade-mark Requirement and Control/Assistance Requirement, the franchisor (or its associate) grants the franchisee representational or distribution rights (whether or not a trade-mark is involved) to sell goods or services supplied by
The three key elements of the business format definition (i.e., the Payment Requirement, the Trade-mark Requirement and the Control/Assistance Requirement) are present in the typical or traditional franchise model used by such well-known systems as Tim Hortons and McDonald's. The difficulty is that this traditional conception of franchising, as being the stuff of large, quick-service restaurant chains, is far too limiting and can lead lawyers (and their clients) to overlook the possibility that the business arrangement they are contemplating also constitutes a "franchise" under the terms of the Act.

Firstly, franchising is by no means limited to the fast food industry. Indeed, there are many types of retail chains that are in fact franchises, but which are often assumed by people outside the franchise industry to fall outside the ambit of the Act. These include:

- home service providers (e.g., Merry Maids);
- gas stations (e.g., Petro-Canada);
- car dealers (e.g., GM);
- grocery stores (e.g., Loblaws);
- movers (e.g., Two Men and a Truck);
- business service providers (e.g., The UPS Store); and
- education/tutoring service providers (e.g., Kumon).

Secondly, because the three elements of the definition are so broadly drafted, many relationships, that are neither expected nor intended by the parties or their counsel to be subject to franchise

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the franchisor or one of its designated suppliers, and provides location assistance, including securing retail outlets or accounts for the goods or services to be sold, or securing locations or sites for vending machines, display racks or other product sales displays used by the franchisee.
legislation, are subsequently held to be franchises; usually, when the relationship has soured and one party (typically, the franchisee) asserts its rights and remedies under the Act to the surprise of the franchisor.

For example, the Payment Requirement includes, not only up-front payments like initial franchise fees or the ongoing payment of royalties for the use of the trade-marks, but also any other payment made to the franchisor or its associate in the course of operating the business. In other words, it includes payments such as those in respect of purchases of inventory and payments of rent (if made directly to the franchisor or its associate).

Similarly, the Trade-Mark Requirement does not specify that the licensee's business must be branded with the franchisor's marks, but rather that the products or services it sells or offers for sale as part of that business be substantially associated with the franchisor's marks.

Finally, the Control/Assistance Requirement is arguably also quite broad, given the use of the word "significant", rather than a stronger word, such as "substantial" or "definitive" or even "full". Very little helpful judicial guidance on this issue has been forthcoming, with the exception of the comparatively recent emphasis placed by the Ontario Superior Court of Justice on the relevant control or assistance: (a) having to occur during the term of the agreement, rather than as a condition precedent to the grant, and (b) having to relate to the method of operation of the franchised business, rather than to the products or services being sold.11

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10 Note that this is not the case in other provinces, which expressly exclude purchases of reasonable amounts of inventory at bona fide wholesale prices (see s. 1(1)(f), Alberta Act (definition of “franchise fee”), s. 2(3)(g), Prince Edward Island Act, s. 2(4)(g), New Brunswick Act and s. 2(3)(j), Manitoba Act).

All of this breadth and uncertainty means that one must be extremely careful to consider all of the aspects of a "franchise" in almost every sales or distribution context. If this exercise is not promptly and properly undertaken before the arrangement is concluded, the parties may be faced with an "accidental franchise". The implications of that accident are discussed in the next part of this paper.

Three additional (related) points should be noted:

1. The parties' intention does not matter. The test of whether a given relationship constitutes a "franchise" is purely factual in nature - if it walks like a duck, and squawks like a duck, it will most likely be found to be a duck;

2. It does not matter whether the term "franchise" is used in any of the documentation or correspondence between the parties, or if they expressly choose to refer to the relationship by another name (such as a "license" or "distribution agreement"); and

3. It is not possible to contract out of the Act and its requirements. Section 11 of the Act expressly provides that, "[a]ny 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."

The bottom line is that if you, as a lawyer, fail to recognize your client's relationship as a franchise, you will be unable to advise your client as to its rights and obligations under the Act, and you will expose yourself to a possible claim for negligence.
Key Elements of the Act

What, then, are the principal rights and obligations imposed by the Act?

Disclosure

The principal obligation under the Act, and the only one with a clear, physical manifestation, is that of disclosure. Specifically, under subsection 5(1) of the Act, a franchisor must provide a prospective franchisee with a disclosure document that meets the requirements of the Act and Regulations 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 the franchisor's associate relating to the franchise.

It is generally accepted that the purpose of disclosure is to provide a prospective franchisee with all of the information they would require to allow them to make a properly informed decision as to whether to acquire the franchise being offered. In accordance with section 5(4) of the Act, the disclosure document must 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.

As is discussed in greater detail below, and as is evident on the face of the above requirements, the information set out in the Regulations as being required to be included in a disclosure document is not exhaustive; rather, the document must contain all "material facts", including those set out in the Regulations. The definition of "material fact" is quite broad. Under subsection 1(1) of the Act, "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.[

This requirement effectively forces the franchisor to put itself into the shoes of the franchisee and to consider what it would want to know prior to buying the franchise in question. This typically entails a rather intensive due diligence exercise, which the franchisor's lawyer is well-advised to direct.

Fair Dealing

Whereas the disclosure requirement is typically regarded as being completed before the franchised business opens and the relationship really begins (although it does arise again on any
renewal or extension of that relationship), the duty of fair dealing applies throughout the relationship, up to and including its termination.

Under section 3 of the Act, every franchise agreement imposes on each party a duty of fair dealing in its performance and enforcement, and that duty of fair dealing includes the duty to act in good faith and in accordance with reasonable commercial standards. While our courts have held that the duty is not fiduciary in nature, the jurisprudence is ever-expanding to reflect, and to use this statutory duty to address, the typical power imbalance between franchisor and franchisee.

Franchisees' Right to Associate

Finally, under section 4 of the Act, a franchisee may associate with other franchisees and may form or join an organization of franchisees, and the franchisor may not interfere with, prohibit or restrict, by contract or otherwise, or directly or indirectly penalize, attempted penalize or threatened penalize a franchisee for, exercising such right. A provision in a franchise agreement or other agreement relating to the franchise, which purports to interfere with, prohibit or restrict a franchisee from exercising its right, is void.

The Consequences of a Franchise Accident

For the Franchisor

For the franchisor, the consequences of failing to comply with the Act can be quite severe. It is critical for the franchisor to understand that the Act is generally understood (including by our

13 See, most recently, *Fairview Donut Inc. v. The TDL Group Corp.*, 2012 ONSC 1252 (CanLII).
courts) to be remedial legislation, enacted primarily for the protection of franchisees.\textsuperscript{14} While everyone is keenly aware of the high level of interdependence between franchisors and their franchisees, the inescapable fact is that the franchisor, by definition (i.e., as an insider), has far more and better information about its franchise system than does a prospective franchisee (i.e., as an outsider). Moreover, in all but the earliest stage of the franchise system's development, it is the franchisee which, relatively speaking, has the most at stake by entering into the franchise relationship: while the franchisor's risk is typically spread over a number of locations, the franchisee has likely staked his or her entire livelihood and family's assets on just one. It is also arguably with this imbalance in mind, that the Ontario Legislature fashioned the Act's remedies as robustly as it did.

These remedies fall into two general categories: Rescission and a statutory action for Damages.

1. Rescission

Subsection 6(1) of the Act provides that:

"[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".

Similarly, Subsection 6(2) of the Act provides that:

\textsuperscript{14} See, for example, \textit{Personal Service Coffee Corp. v. Beer} (2005), 256 D.L.R. (4th) 466 (Ont. CA), at para. 28.
"[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".

In other words, a failure by a franchisor to make proper or timely disclosure may give the franchisee the right to walk away from the franchise. But rescission, both as it is understood at common law and under the Act, also entails putting the parties back into the positions they occupied before entering into the contract in question. The key difference to note between the Act and common law is that the Act is really only concerned with restoring the position of the franchisee.

Specifically, in the event that a franchisee rescinds its franchise agreement, subsection 6(6) of the Act requires the franchisor (or its associate, as the case may be), within 60 days of the effective date of the rescission, to:

(a) refund to the franchisee any money received from or on its behalf (other than money for inventory, supplies or equipment, which are dealt with separately below);

(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).

Two key points should be noted about these requirements: first, the obligation on the franchisor to purchase inventory, supplies and equipment on-hand extends beyond such items as the franchisor or its associate sold to the franchisee, and instead covers also items acquired by the franchisee from third parties. Second, and more importantly, the obligation to compensate the franchisee for its losses in clause (d) extends beyond the acquisition and start-up phase of the business to include all operating losses suffered by the franchisee during the period leading up to the date of rescission. In other words, by failing to disclose as required by the terms of the Act, the franchisor is effectively insuring the franchisee's business losses for either its first 60 days or its first two years of operation, depending on which limitation period applies.

This is an extremely powerful remedy which goes beyond the remedies available to franchisees in most other jurisdictions (i.e., other than the four other Canadian provinces which have adopted franchise legislation not dissimilar to that of Ontario). If vigorously pursued, particularly by multiple franchisees (including by way of class action), the rescission remedy can effectively cripple, and perhaps bankrupt, all but the hardiest of franchisors. And when its full force is brought to bear on a particular franchisor (or when the opportunity is missed due to the
inadvertence of franchisee counsel), it is not surprising that the parties will focus at least some of their attention on the actions and omissions of their lawyers.

2. Damages

The other remedy expressly available under the Act is the right to bring an action for damages against the other party for a breach of the Act's requirements. Each of section 3 (Fair Dealing) and section 4 (the Right to Associate) of the Act contains within it an express right of action for damages in favour of the aggrieved party. Under section 3, as the duty is reciprocal, the right of action could be against either the franchisor or the franchisee, depending on who is in breach. Under section 4, as the right to associate belongs solely to the franchisee, the right of action is only against the franchisor or its associate. By enshrining these rights of action within the Act, the Legislature has effectively obviated the need for the aggrieved party to establish a duty in its favour at trial, which the other party has allegedly breached.

Further and similar provisions exist with respect to the franchisee's right of action for damages arising out of the franchisor's duty to disclose. Under subsection 7(1) of the Act, if the franchisee suffers a loss because of a misrepresentation contained in the disclosure document or in a statement of material change, or as a result of the franchisor's failure to comply in any way with section 5 (Disclosure), the franchisee has a right of action for damages against:

(a) the franchisor;
(b) the franchisor's agent;
(c) the franchisor's broker;
(d) the franchisor's associate; and
(e) every person who signed the disclosure document or statement of material change.

In addition, under subsections 7(2) and (3) of the Act, the franchisee is deemed to have relied on the misrepresentation in question and the other information set out in the disclosure document for the purposes of its claim, thereby removing another hurdle the franchisee would otherwise have to clear at common law.

Clause (e), above, is extremely important, as it effectively imposes personal liability on each director or officer who signs the franchisor's disclosure document. While corporate indemnification obligations and directors' and officers' errors and omissions liability insurance (if available) may provide the relevant signers with a safety net, the franchisor's lawyer is well-advised to underscore the prospect of personal liability to them in order to allow them to put such appropriate protections in place and, more importantly, take their obligations seriously and discharge them properly.

The above list is also notable, not just for the categories of persons who appear on it, but also for those that do not. In particular, it is important to note that the franchisor's lawyer does not appear on the list (or, for that matter, on the lists contained in the legislation of the other provinces who currently have it). While this does not mean that a claim cannot exist by a franchisee against her franchisor's lawyer at common law (e.g., for negligence or an independent tort), it is at least some evidence that the franchisor's lawyer was not considered by the Legislature as a person who should be financially responsible directly to the franchisee for the failings or breaches of his or her franchisor client.
It also, most certainly, does not mean that the franchisor's lawyer will not be exposed to a claim by his or her own client, in the event that a claim is successfully prosecuted by franchisee against the franchisor, if the actionable breach occurred as a result or on the advice of a lawyer. In fact, it is those sorts of breaches (and the corresponding failures by some franchisees' lawyers to recognize them) that have fueled many of the claims against Ontario's franchise lawyers.

For the Franchisee

As was alluded to above, the most significant risk of a franchisee's failure to comply with the Act is the comparatively rare occurrence of a claim by a franchisor against the franchisee for breach of its statutory duty of fair dealing - such a claim, if it occurs, would typically arise in the context of an action by the franchisor in respect of the franchisee's alleged breach of the franchise agreement, or as a counterclaim against a franchisee who is suing to enforce its own remedies. As is discussed below, however, for the franchisee's lawyer, the biggest risk is her failure to recognize the availability of potential remedies in favour of her client, either because she has failed to recognize the constituent elements of the claim or because she has failed to do so before the relevant limitation period has expired.

The Most Common Franchise Accidents

Most franchise accidents happen with respect to disclosure, and fall into three broad categories: Timing Accidents, Content Accidents, and Formal (or Procedural) Accidents.
Timing Accidents

1. Franchisors failing to wait 14 clear days

As was noted above, the Act requires the disclosure document to be delivered no later than 14 days before the prospective franchisee signs any agreement in relation to the franchise or pays any money to the franchisor or its associate, whichever is earlier. While it would seem to be a comparatively easy matter to count out 14 days, franchise parties and their counsel often find themselves being pressured by circumstances (such as looming month- or year-ends, availability of leased premises, and so on) and thus feel tempted to cut the relevant waiting period as close as possible. For the franchisor, giving in to this temptation is not recommended, since cutting too closely can lead to a finding that the disclosure document was delivered late, and thus to a claim for rescission, as is discussed in greater detail below.

While arguments can be made to the effect that one may include the day on which the franchisee either signs the agreement or pays any money in the 14 days,\(^1\) it is safer to allow 14 clear days to pass between the date of delivery of the disclosure document and the earliest date on which the agreement is signed or money is accepted. And since our courts are clearly inclined to hold franchisors to strict compliance with their statutory obligations, it is truly better to be safe than sorry.

The other way in which franchisors often compromise the 14-day waiting period is by having the prospective franchisee pay a deposit (even one that is fully refundable) or sign a preliminary

\(^1\) I.e., including on the basis of Ontario's statutory interpretation legislation, the *Legislation Act, 2006*, S.O. 2006, c. 21, Sched. F.
agreement, such as a non-disclosure agreement or letter of intent, before delivering the disclosure document. You should be aware that the term "franchise agreement" is defined in subsection 1(1) of the Act to mean, "any agreement that relates to a franchise" between a franchisor or franchisor's associate and a franchisee. In other words, those preliminary agreements are considered "franchise agreements" for the purposes of the Act. By accepting a deposit or having a franchisee sign such a preliminary agreement before delivering disclosure, the franchisor will have rendered its disclosure document late, by definition, and will have opened itself to the rescission remedy discussed above.

2. Franchisees missing the limitation periods for rescission and other remedies

On the other side of the coin, as was suggested above, the franchisee's counsel must also be keenly aware of the dates on which disclosure was made, documents were signed and money was paid, as well as the sufficiency and accuracy of the disclosure document, itself, in order to properly assess the franchisor's compliance with the Act and the potential availability of remedies for the franchisee. In addition, however, there are limitation periods during which those available remedies must be exercised, and it is up to the franchisee's lawyer to ensure that those limitation periods are not missed.

As was discussed in detail above, a rescission notice must be delivered within the time allowed under the Act, depending on whether disclosure was late or deficient (in which case the rescission notice must be delivered within 60 days following the date the disclosure document was received) or not made at all (in which case the rescission notice must be delivered within two years following the date the franchise agreement was entered into). Similarly, Ontario's
general two-year limitation period will typically apply to claims for misrepresentation or other breaches of the Act and Regulations.

While none of this is unique to the franchise context, the issue of missed limitation periods certainly arises in this practice area as much as in any other. Moreover, the robustness of the statutory remedies discussed above makes their loss due to a technical oversight all the more painful for the franchisee, and arguably makes the franchisee all the more likely to take action against his or her lawyer.

Content Accidents (Franchisors)

1. Failing to include everything on the laundry list

As noted above, a valid disclosure document must include (at least) all of the elements set forth in the Regulations; and if it does not, the franchisee may be entitled to rescission. The question is whether the rescission right extends for 60 days or the full two years.

Certain items are considered so fundamental that their omission (alone) renders the disclosure document completely invalid, such that the two-year rescission period will be available. Chief among these are the financial statements (which must either be audited or prepared subject to a review engagement – “notice to reader” statements are not compliant!) and the assumptions underpinning any earnings projections. In addition, the failure to include a copy of the head

lease where the franchisee is required to sign a sublease, whose terms incorporate terms of the head lease by reference, has also been held to be an important omission of a material fact.\textsuperscript{17}

2. Failing to include "Material Facts" beyond the laundry list

As was also noted above, the franchisor is required to include not only those items which appear expressly in the Regulations, but also any other material facts. These may include such "hard" materials in the franchisor's possession as historical financial information or other performance data in respect of an existing location which is being sold, but may also include such comparatively "soft" information as sample figures provided in preliminary discussions between the franchisor (or its salesperson) and the franchisee, before an application is even signed or contemplated.

3. Misrepresentation

Of course, the most obvious way to create a content accident is simply to misstate facts, with or without the intention to mislead. As with any client in any area of practice, the Rules of Professional Conduct dictate what we all must do when faced with a client who actively seeks to mislead another through work we are being asked to produce, including always being, "on guard against becoming the tool or dupe of an unscrupulous client".\textsuperscript{18} But actionable misrepresentations in franchise disclosure documents need not be intentional, and as was discussed above, the franchisee will be deemed to have relied upon the contents of the document irrespective of whether the relevant inaccuracy or omission was malicious or inadvertent.

\textsuperscript{17} See Dollar It, \textit{Supra}, note 12.

\textsuperscript{18} Law Society of Upper Canada, \textit{Rules of Professional Conduct} adopted by Convocation June 22, 2000, as amended, section 2.02(1), Commentary.
Formal/Procedural Accidents

1. Franchisors making "Piecemeal Disclosure"

In accordance with Subsection 5(3) of the Act, "[a] disclosure document must be one document, delivered [...] as one document at one time." This means that all of the material facts relating to the franchise opportunity (including those required specifically by the Regulations) must be contained in a single (ideally, bound) package, delivered to the prospective franchisee on one occasion.

This issue was addressed by the Ontario Court of Appeal in *Dig This Garden*, one of the earliest cases decided under the Act. In deciding in favour of the franchisee, the Court held that it was insufficient for the franchisor to have provided information about the franchise system, both orally and in writing, from time to time both before and after the required time for disclosure had passed: the subsection 5(3) requirement was not a mere formality which may be complied with in spirit. Instead, the Court held that failure to provide key documents, such as financial statements and certificates, together as one document with all of the other information required by the Act and Regulations, meant that no disclosure had been made, and that the franchisee was entitled to rescind within two years following the date of the franchise agreement.

2. Franchisors failing to have two directors or officers sign the disclosure document

Section 7 of the Regulations requires that every disclosure document include a certificate certifying that the document contains no untrue information, representations or statements, and

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19 *Supra*, note 11.
that it includes every material fact, financial statement, statement and other information required by the Act and the Regulations. This certificate must be signed and dated by the franchisor. Where the franchisor is an individual, that individual must sign the certificate. However, it is extremely rare (and generally ill-advised) for a person to grant franchises in their personal capacity; rather, in almost every case, the person who is seeking to start a franchise business will (and should be advised to) incorporate a franchise corporation to hold the trade-mark rights and other assets to be licensed or otherwise provided to the franchisees.

Under those circumstances, subsection 7(2) of the Regulation requires that at least two persons, who are officers or directors of the franchise corporation, sign and date the certificate (i.e., except where the corporation has only one director or officer, in which case that individual must sign the certificate alone).\textsuperscript{20} As was discussed above, those signatories will be personally liable for any misrepresentations contained in the disclosure document.

More importantly, however, as is the case with the fatal content omissions discussed above, where the franchisor delivers a disclosure document that is not properly signed and dated, the disclosure document will be considered a legal nullity and disclosure will be deemed simply not to have been given.\textsuperscript{21} In other words, no matter how complete the content of the disclosure document or the timeliness of its delivery, if the document is not properly signed and dated, all of that effort will have been for naught.

\textsuperscript{20} As a further matter of formality, the signature lines on the certificate should reflect only each signer's name and title (e.g., Jane Doe, President; John Smith, Director) as opposed to the name of the corporation followed by the names of the officers or directors signing on its behalf (e.g., Franchise Co., per: Jane Doe, President and John Smith, Director), as each signer, not the corporation, is certifying the information and will be held personally liable.

3. Franchisors using electronic delivery

In accordance with subsection 5(2) of the Act, "[a] disclosure document may be delivered personally, by registered mail or by any other prescribed method." As there are currently no other methods prescribed, the question often arises as to whether a franchisor may deliver a disclosure document by electronic means.

The short answer is that electronic delivery is inadvisable, as its use could result in a finding that the disclosure document was never delivered and that the franchisee is thus entitled to rescind the franchise agreement. While it is hoped that this may be one area in which the Act might be amended in the near future, in the continued absence of an express provision permitting electronic delivery (as appears, for example, in the franchise legislation of Prince Edward Island, New Brunswick and Manitoba\(^{22}\)), it should simply be avoided.

4. Franchisees not properly drafting or delivering their notice of rescission

As was discussed above, there are strict time periods within which a rescission notice must be delivered. In addition, however, the Act also requires (in subsection 6(3)) that the notice be in writing and that it be delivered to the franchisor personally, by registered mail, by fax or by any other prescribed method, at the franchisor's address for service or to any other person designated for that purpose in the franchise agreement. Failure to comply with these formalities may result in the franchisee losing the benefit of any rescission remedy that would otherwise be available. Again, it is up to the franchisee's lawyer to make sure that this does not occur.

\(^{22}\) See PEI Reg. Chap. F-14.1, s. 2(b), New Brunswick Regulation 2010-92, s. 3(1)(b) and Manitoba Regulation 29/2012, s. 5(1)(b).
Top 10 Tips for Avoiding Franchise Accidents

So, how can you avoid (or at least reduce the chance of) these franchise accidents happening to you and your clients?

1. Read the Act and Regulations, then, read them again.

While it may appear to some that an enactment containing a mere 13 operative sections could not possibly be that complicated, as the above discussion demonstrates, there is a great deal of nuance and complexity that is built into those 13 sections. Similarly, while the list of items to be included in a disclosure document as set out in the Regulations is not exhaustive, it does typically form the bulk of the content that ultimately appears in the document. It is easy enough to fall down on one of the more technical aspects of compliance – don’t make it harder on yourself by missing something that is apparent on the face of the legislation.

2. Keep your eyes open - franchises are everywhere!

As noted, many types of relationships, including those which the parties expressly intend not to be franchises, may in fact be caught by the Act, potentially resulting in unanticipated liability for the franchisor and un-bargained for remedies for the franchisee. It is up to you, as counsel to either party, to identify such possible situations and to ensure that your client is aware of, and thus able to deal with, the resulting consequences. Accordingly, whenever you are faced with a manufacturer or distributor who is selling branded products or services through a third party, whether you are acting for the manufacturer/distributor or for the third party, you should closely
examine whether the relationship constitutes a "franchise", and carefully consider whether the Act therefore applies.

3. Watch the calendar.

Whether you are acting for the franchisor or franchisee, the easiest way to invite a claim for negligence in this area is to fail to appreciate and abide by the strict timelines and limitation periods mandated by the Act. Be aware of them and count carefully!

4. Get the Franchisor to control its sales people and process.

As was suggested above, many times franchise salespeople will give prospective franchisees charts, graphs or even numbers scratched on the back of a napkin before the disclosure document is delivered (or, in some cases, before it is even prepared). This is not just a single-vehicle accident – it is potentially a multi-car wreck.

Very early on in your retainer with a franchisor, you must impress upon your client that anything the franchisor (or its salesperson or agent) thinks is important enough to tell a prospective franchisee during the sales process is, by definition, a material fact that must be included in the disclosure document. If this is not done, the franchisor may find itself the victim of both a content accident (i.e., failing to disclose all material facts in its disclosure document) and a formal accident (i.e., making piecemeal disclosure). Moreover, if the information has to do with anticipated costs or performance of the franchise being sold (as it usually does), then, not only must the information itself be included in the disclosure document, but the franchisee must also be given information about the reasonable basis underlying those estimates and information as to
where they can go to examine information that substantiates them\textsuperscript{23} (i.e., another potential content accident).

5. Do your homework, and help your client do theirs.

While a franchisor's lawyer should never lose sight of the fact that the disclosure document is the franchisor's document (a fact that is surely brought home by the fact that the franchisor is required to certify the accuracy and completeness of its disclosure document, on pain of personal liability), it is nonetheless the lawyer's responsibility to assist his or her client in fully discharging its obligations to create and provide a document that is fully compliant with the law. Depending upon the client, this may involve most, if not all, of the following steps:

i. Impressing upon the client the importance of complying with the Act and Regulations.

Given the extensive nature of the disclosure requirements, clients sometimes display a reluctance to make full disclosure, particularly with regard to financial statements, especially where the franchisor is not a public company, but rather a closely-held (often family-run) business. In addition, particularly with start-up franchisors, the cost of producing a compliant disclosure document may seem overly burdensome in light of the other up-front costs it must incur.

It is your job, as the franchisor’s lawyer, to explain to your client the significant exposure a rescission or misrepresentation claim could entail if the Act is not followed and in some cases, as discussed above, to convince the franchisor that the application of the Act is

\textsuperscript{23} Regulation ss. 6(2) and 6(3).
indeed broad enough to capture the relationship it has in mind, notwithstanding its (or perhaps both parties') sincerely-held belief or desire that the relationship not constitute a "franchise". Do not shrink from that responsibility.

ii. Directing the franchisor's due diligence effort.

Once you have the franchisor's attention and buy-in, the real work of gathering and verifying the information to be included in the disclosure document begins. This effort will typically involve:

- **Identifying an internal point person or compliance officer.**

  It is crucial that someone within the franchisor's organization is tapped to be the person responsible for gathering and compiling the information required to be inserted in the disclosure document. The more senior that person is, the better, as increased seniority will both send the message that management takes the task seriously and assure a measure of continuity over time (since, as is discussed below, the disclosure document will have to be kept current). It can also be a cost-saving measure, since, in the absence of an internal quarterback, that task will fall to external counsel, which will increase costs significantly and may actually reduce the likelihood that the job will get done properly, due both to a lack of access to key people and to a lack of knowledge about the inner workings of the franchisor.
• Having the franchisor complete a detailed questionnaire about itself and the franchise opportunity.

Particularly in cases where the franchisor is still relatively small and thus has little or no internal legal support, a detailed, plain language questionnaire designed to elicit the information required to be disclosed, will be critical. Depending on the size and complexity of the franchisor's organization, multiple questionnaires might be used and disseminated to the heads of various functions within that organization. For example, separate questionnaires might be sent to the CFO and director of franchising, and individual director and officer questionnaires might be used to flesh out each individual's background, having regard to the information that must be disclosed about them (i.e., the relevant business experience, five-year employment history, past convictions, administrative orders or penalties, bankruptcies, and so on).

Regardless of how you structure your questionnaire(s), be sure to ask the respondents to take their time and write out detailed answers to the questions – this will allow you more flexibility on how much detail to include and may also trigger follow-up questions that might not arise out of a sparser response.

• Reviewing existing disclosure documents.

In the case of an existing franchisor, the client may already have an existing disclosure document that it has previously used, either in Ontario or perhaps in
another jurisdiction. If the existing document is an Ontario document, the exercise will be focused on updating it to provide the most current information. You should be careful, however, not to rely too heavily on the past document, since it may not have been compliant at the time it was created, and/or the law may have changed in the meantime, such that a higher standard of disclosure now applies.

If, on the other hand, the existing document was prepared for another jurisdiction, you should be aware that, unlike the other Canadian provinces, it is not possible in Ontario to take a disclosure document that was prepared for use in another jurisdiction and simply supplement it to cover all of the additional Ontario-specific information required. Not only does the Act not expressly permit you to do so, but the formalities under the Act and Regulations are sufficiently unique as to render such a move practically impossible. That said, there may be useful information contained in the existing document which can supplement and corroborate the information provided by the franchisor in its questionnaire, and you should review the document, if for no other reason than to assure an appropriate level of consistency.

iii. Conducting your own due diligence, including from public sources and (if the franchisor is an existing client) your own files.

In addition to the materials provided by the franchisor, it may be useful for you to consult public sources, including the Internet and securities filing databases (if the franchisor
entity is public) – notes to the franchisor’s financials and the franchisor’s product and franchise sales materials are also excellent sources of information.

While it may make sense to supplement or corroborate the franchisor's information in this fashion, as with any client relationship, you must first know your client in order to gauge whether such additional effort will be welcomed or instead regarded as mistrustful, or even antagonistic. When in doubt, ask.

iv. Helping the franchisor identify material facts and determine the level of detail to disclose.

Once you have all of the raw information from the sources described above, it will be important to determine what rises to the level of materiality and how much detail to go into in describing it. One of the more difficult parts of the exercise can arise when there are certain potentially embarrassing facts, which the franchisor is reluctant to disclose (e.g., past bankruptcies, criminal convictions, damaging lawsuits, and so on). In such circumstances, the lawyer must remind his or her client as to the importance of the exercise and the tremendous risk that the client runs by not completing it fully and properly. Unlike other jurisdictions, such as the United States, where the public filing of disclosure documents is required, no Canadian province requires any such filing, so that the only people who will see the information are the prospective franchisee and its advisors. Moreover, as embarrassing as the disclosure of certain facts might be, the properly-advised franchisor almost invariably comes to the conclusion that the prospect of rescission is far worse.
In terms of the level of detail to disclose, you should bear in mind that subsection 5(6) of the Act requires that all information in the disclosure document must be "accurately, clearly and concisely" set out. In other words, you must engage in a balancing exercise between providing every last detail and risking the production of a document that is less than clear or concise, and providing somewhat less detail and risking the production of a document that either does not contain all material facts or is misleading in their presentation. Here, you are best advised to try to put yourself into the shoes of the prospective franchisee and to ask yourself how much detail is truly relevant to your decision whether to buy the relevant franchise, versus whether the additional detail would simply distract you from the information you actually care about.

v. Helping the franchisor identify any additional material facts.

While a good questionnaire should elicit the vast majority of material facts about a given franchisor and franchisor opportunity, even the best generic questionnaire will not necessarily get at all material industry- or system-specific facts; much less, location-specific facts that need to be disclosed in the case of the sale of an existing franchised outlet. The franchisor's answers may lead to additional questions, and you would be remiss in not following them up. Remember that the question of adequate disclosure is a franchisee-focused exercise, with the object being to provide the prospective franchisee with all of the information it reasonably requires to make a fully informed decision about acquiring the franchisor – in other words, it is a *subjective* test.
You should note that this is different (and more onerous) than what is required in certain other jurisdictions. For example, to the extent that you are dealing with an existing US franchisor who is looking to expand to Canada, the notion of customizing its disclosure document and going beyond the laundry list of information required by the Regulations will seem unnatural and foreign to the franchisor, since that is not the way it is done in their home jurisdiction. As in the case of a franchisor who is reluctant to disclose embarrassing facts, however, you will need to be firm and impress upon them the seriousness of their obligation to make full disclosure, and the consequences of failing to do so.

6. If you've screwed up, ‘fess up’ and fix it.

In many cases, mistakes made by a franchisor or its counsel in the disclosure process are fixable, if they are caught and dealt with promptly. For example, if you discover that disclosure was not made when it should have been, and you are still within the first two years of the franchise agreement's term, it may make sense to make late disclosure and potentially limit the rescission period to 60 days from the date of that disclosure, rather than to do nothing and wait for the two years to expire. Obviously the late disclosure option is more feasible and attractive, the earlier in the term you discover the mistake.

If, on the other hand, disclosure has been made (on time) and you later realize that it was either incomplete or inaccurate – for example, not all of the documents the franchisee is required to sign were attached to the disclosure document (e.g., the premises lease or sublease is finalized later because the precise location of the outlet was not known at the time of disclosure), or
material facts were either omitted or misstated in the disclosure document – you may have an opportunity to correct such errors or omissions with little or no liability.

If such a discovery is made during the 14-day waiting period (or afterwards, as long as no money is paid and nothing is signed), depending upon the nature and extent of the discrepancy, it may be possible to deliver a statement of material change with the supplemental information or documentation. This is however not recommended unless the difference between what was delivered initially and what should be delivered actually results from a change in circumstances or the availability of information or documents that were not available at the time the initial disclosure was made – the material change statement is not a tool for correcting items that were wrong from the start.

If, on the other hand, you discover an actual mistake in the disclosure that was delivered or the franchisee has already signed the documents or paid money to the franchisor or its associate, your only option may be to refund the franchisee's money, tear up all of the signed agreements, and re-disclose. Again, this becomes harder to do, as a practical matter, the farther into the relationship you get.

In any such case, in addition to considering a call to LawPRO, you should consider consulting an experienced franchise lawyer who will be able to help you identify the best option to correct the error and minimize both your client's and your own liability.
7. Keep revisiting, revising, and updating.

As with any other area of law, franchise law is still evolving. The Act has only been in force for approximately 11 years and our courts are still grappling with its interpretation and application. What is (or is not) a "franchise" today may (or may not) be one tomorrow. Moreover, court decisions are being reported continually regarding what constitutes a franchise accident and what remedies are available.

In addition, you should bear in mind that disclosure documents are, by their nature, evergreen. Material facts change all the time and disclosure documents must be updated regularly to reflect such changes. They are also not necessarily generic – as discussed above, each disclosure document must be tailored to fit each situation, and while many material facts will be common to most franchise opportunities being offered by a given franchisor, again, you must always remember that the disclosure exercise is inherently subjective from the point of view of the franchisee, so that the possible inclusion of site-, franchisee- or deal-specific information must always be considered.

Accordingly, as franchisor's counsel, you should meet regularly with the client’s point person in the due diligence process to ensure that: (a) the disclosure document is regularly updated and kept current, so that all new or changed material facts are reflected in the disclosure document given to each new (or renewing) franchisee, and (b) the appropriate level of customization takes place.

This is an old adage, but it bears repeating. Franchise lawyers are no different than any others when it comes to practising defensively. The sooner in your retainer that you identify your client's statutory obligations and risks of non-compliance, the better, and the best way to protect yourself from the client who, when things go wrong, looks to you for recourse, is to put all of that advice in writing before you begin your work. These matters should again be addressed, and coupled with detailed instructions as to how the client is to discharge its obligations, going forward, in a comprehensive reporting letter given to the client at the end of the retainer.

Similarly, to the extent that any of the specific issues, discussed above, arise during the course of your work, you should also follow up any oral advice you give to the client with a short note summarizing your advice. With the thornier issues, a more formal memorandum, letter or opinion may be in order.

In addition to putting all of your advice in writing, it is equally critical to retain copies of all relevant documents in your file, in the form in which they were delivered to the other party. This includes a bound copy of the disclosure document in the form in which it was delivered and a true copy of any rescission notice, in each case together with the appropriate (signed and dated) receipt and other confirmation of the time of delivery.

9. Don't be a Stranger.

Compliance with the Act and Regulations is neither simple nor costless for your client. Rather, it requires attention to detail at the highest levels of your client's organization and a long-term
commitment in order to discharge the Act's obligations properly. As a franchise lawyer, it is imperative that you maintain contact with your client after your initial advice has been given, and even after your initial retainer has been discharged. Too often do franchisors go off on their own after having received their lawyer's advice and the lawyer has no idea whether and how that advice is being followed. While a solid retainer letter and detailed reporting letter will go a long way toward avoiding problems, often nothing is as effective as periodic follow-up telephone calls and, ideally, face-to-face meetings.

Similarly, on the franchisee side, it often takes some time before the franchisee develops an accurate picture of the franchise business it has just bought and has enough information to determine whether it wants to seek a potential remedy. Particularly where you are of the view that rescission might be an option, you would be well-advised to diarize a follow-up date or dates, both within the 60-day and 2-year rescission periods, (a) to contact your client to see how their businesses going, and (b) if it is going poorly, to revisit and re-evaluate the strength of their potential claim with the benefit of both hindsight and the subsequent release of more recent jurisprudence.

10. Get involved!

Finally, the best way to keep current on franchise law and best practices, and thus to stand the best chance of avoiding franchise accidents of all sorts, is to become an active participant in the various forums, programs and discussions put on by franchise experts throughout the year. The Law Society, the OBA Franchise Law Section, and the Canadian Franchise Association all provide excellent opportunities to learn more about franchise law and to interact with others who
are active in the field. As franchising becomes an even more prevalent form of business structuring and expansion, you may find that it will become a larger part of your practice. As it does (ideally, before it does) you will find significant advantages to being a part of the conversation.

Your clients, and your insurer, will thank you.