

CARSWELL

Canadian Franchise Guide
Second Edition

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QR3.
**10 COMMON MISTAKES IN PREPARING OR
DELIVERING A DISCLOSURE DOCUMENT**

1. Updating only annual information and/or not providing a statement of material change.

A disclosure document is not a static document and should be updated more than once a year. Unless a required disclosure item is described in relation to a specific time period, the disclosure item must be current at the time when the franchisor provides it to a prospective franchisee. There are certain prescribed items for which the relevant disclosure period is determined in relation to either the date of the disclosure document or the date of the franchisor's fiscal year end.

If a prospective franchisee has received a disclosure document but has not yet signed the franchise agreement, the franchisor must also provide the prospective franchisee with a written statement of any material adverse change as soon as practicable after the change has occurred and before the earlier of: (a) the signing by the prospective franchisee of the franchise agreement or (subject to certain exceptions in Alberta, PEI, New Brunswick, British Columbia and Manitoba) any other agreement relating to the franchise; and (b) the payment of any consideration relating to the franchise.

2. Franchisee signs and returns documents within the 14 day period.

The franchisor must deliver the disclosure document *at least* 14 days before the earlier of any payment or the signing of any agreement (subject to certain exceptions in Alberta, PEI, New Brunswick, British Columbia and Manitoba). The 14-day disclosure period must be calculated in accordance with the applicable provincial *Interpretation Act*. In Ontario and New Brunswick, the 14-day disclosure period excludes the day on which the prospective franchisee receives the disclosure document, effectively making the disclosure period 15 days. In Alberta, PEI, British Columbia and Manitoba, both the day on which the disclosure document is received as well as the day on which a franchise agreement is signed or payment is made are excluded from the calculation, effectively making the disclosure period 16 days.

3. Franchisor's certificate is not properly signed.

Certain courts have found that failure to properly execute a franchisor's certificate is tantamount to not providing a disclosure document at all, and gives rise to the full two-year right of rescission. The Ontario, Alberta, PEI, New Brunswick, British Columbia and Manitoba franchise regulations require that

every disclosure document delivered in Ontario, Alberta, PEI, New Brunswick, British Columbia and Manitoba contain a franchisor's certificate in the applicable province's prescribed form. If the franchisor is a corporate entity, the franchisor's certificate must be signed and dated by at least two officers or directors, or by the sole officer or director if the corporation has only one director or officer. If the franchisor is an unincorporated entity, the certificate must be signed and dated by the franchisor. PEI, Manitoba and British Columbia also have a separate prescribed form of certificate to be attached to each Statement of Material Change.

4. No proof of actual delivery of disclosure document.

In the event of a dispute or litigation about the contents of the disclosure document and/or the timing or method of delivery, courts will take a negative inference if the franchisor is unable to produce the actual disclosure document and details about its delivery. The franchisor should ensure that it maintains proper files of what and when disclosure was provided to each prospective franchisee. For example, for each prospective franchisee the franchisor should consider retaining: a record of when the disclosure document was delivered, to whom it was delivered, the method of delivery, a copy of the signed certificate and receipt and a duplicate copy of the entire disclosure document that was delivered to the prospective franchisee, including all exhibits, schedules and the signed franchisor's certificate.

5. Document is not properly delivered in accordance with the applicable provincial legislation.

With the exception of Manitoba, the disclosure document must be a single document delivered at one time, and cannot be delivered piecemeal. Delivering the disclosure document electronically is permitted in PEI, New Brunswick, Ontario, British Columbia and Manitoba, provided delivery is in accordance with the prescribed requirements (See QR-6 Method of Delivery of the Disclosure Document). In Alberta, there are no specific required delivery methods.

The franchisor must deliver the disclosure document *at least* 14 days before the earlier of any payment or the signing of any agreement (subject to certain exceptions in Alberta, PEI, New Brunswick, Ontario, British Columbia and Manitoba). The 14-day disclosure period must be calculated in accordance with the applicable provincial *Interpretation Act*. In Ontario and New Brunswick, the 14-day disclosure period excludes the day on which the prospective franchisee receives the disclosure document, effectively making the disclosure period 15 days. In Alberta, PEI, British Columbia and Manitoba, both the day on which the disclosure document is received as well as the day on which a franchise agreement is signed or payment is made are excluded from the calculation, effectively making the disclosure period 16 days.

6. Incomplete or nonexistent receipt.

While there is no prescribed form of receipt for the disclosure document, it is good practice to develop and use a specific form of receipt. The receipt should evidence when and what was disclosed to the prospective franchisee. As a best practice, the receipt should include an itemized list of all of the attachments to the disclosure document, including the signed franchisor's certificate and reference the date and version of the disclosure document that was received by the prospective franchisee. If the prospective franchisee is a corporate entity, ensure that the receipt is signed and dated by the corporate entity; or, if the corporate entity is not yet incorporated, ensure that the receipt is signed and dated by an individual on behalf of the corporation to be incorporated. Although not specifically required by the legislation, as a best practice, the receipt should also be signed by any authorized signing officer that will sign the franchise agreement or any agreement relating to the franchise and any shareholder or other individual that will, directly or indirectly, guarantee the obligations of the prospective corporate franchisee. If the prospective franchisee is an individual, ensure that the receipt is signed and dated by such individual in his or her personal capacity.

7. Disclosure document not customized for a particular franchisee.

Case law has demonstrated that courts are expecting that disclosure documents be customized to include specific material facts about the actual franchise being granted. Accordingly, the disclosure document must include that prospective franchisee's specific territory, initial fee, performance standards and other information about his or her franchise, not just general descriptions of these disclosure items or formulas for their calculation. If such information is known at the time of disclosure, it must be included in the disclosure document. If it is not known at the time of disclosure, the franchisor should provide the information to the franchisee by way of a statement of material change once it becomes known. Note that there are some franchise practitioners who claim that a statement of material change cannot be used to provide such information, and re-disclosing with a customized disclosure document (and re-starting the 14-day disclosure period) is the only option to proceed. Accordingly, while the use of the statement of material change to provide specific information about the franchise being granted is not without some risk, it is a more practical approach in the circumstances.

8. Disclosure document not specific to a resale or a renewal.

If the disclosure document is being delivered to a prospective franchisee in connection with a resale or renewal of a franchise location, certain information will require customization. For example, the sections in the disclosure document regarding the statement of costs associated with establishing the franchise are probably averages used to reflect the costs for a generic franchise. As a resale is for a specific franchise, this section of the disclosure document must be modified to reflect the actual historical costs of the franchise location in question. Simi-

larly, a renewing franchisee will not bear the same start-up costs as part of continuing the operation of the franchised business as will a new franchisee. In addition, although not specifically required by the franchise legislation, there is a good argument that, in the context of a resale, historical financial information of the existing franchise constitutes a “material fact” and therefore, must be disclosed to the prospective franchisee.

9. Undisclosed “material facts”

Canadian franchise legislation require that all “material facts” relating to the franchise be included in the disclosure document. When deciding whether a particular piece of information is a “material fact”, franchisors should first consider whether the fact falls within the categories of information covered by the definition of “material fact” in the applicable province’s franchise legislation. If so, franchisors should further consider whether the fact could reasonably have a significant effect on the value or price of the franchise or the prospective franchisee’s decision to purchase the franchise. When performing this analysis, franchisors must exercise reasonable judgment, and weigh the likely significance of the information from the prospective franchisee’s point of view. If the answer to both of these questions is yes, this fact is material and must be disclosed. A franchisor should also consider whether its sales team intends to use or provide this information to a prospective franchisee during the franchise sales and disclosure process. If the answer to this question is yes, this information is likely important, regardless of whether it has a positive or negative impact, and will likely constitute a “material fact” that should be disclosed.

10. Business plans vs. earnings claims.

The disclosure regulations in all provinces provide that the provision of an earnings projection is voluntary, but if the franchisor elects to do so, it must also provide certain information, including assumptions and explanations about the projection. However, franchisors must be aware that the disclosure regulations in PEI, New Brunswick, British Columbia and Manitoba define an “earnings projection” to include any information given by or on behalf of the franchisor or franchisor’s associate, directly or indirectly, from which a specific level or range of actual or potential sales, costs, income, revenue or profits from franchises or businesses of the franchisor or the franchisor’s associates of the same type as the franchise being offered can easily be ascertained. Alberta also adopts the same approach to what can constitute an “earnings projection”. Accordingly, franchisors must carefully consider the nature of any financial information provided to franchisees at any time before or during the disclosure process in order to avoid inadvertently providing an earnings projection. This situation can arise even if the franchisor has no intention of providing an earnings projection (e.g., reviewing and approving a proposed business plan). If so, the information must be included in the disclosure document and accompanied by all required assumptions and explanations. Failure to do so could lead not only to a rescission claim for a deficient disclosure document, but also for misrepresentation due to the missing

information. While the franchise legislation in Ontario does not expressly define “earnings projection”, similar concerns could arise in this province. Franchisors should be equally cautious to ensure that any information that they are providing to franchisees that may constitute an earnings projection should be included in the disclosure document with appropriate disclaimers.

