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Rescission decision emphasizes potential disclosure exposure

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In *Giroux et al. v. 1073355 Ontario Ltd. et al,* 2018 ONSC 143 *(Giroux)*, franchisees sought a declaration, on a summary judgment motion, that they were entitled to rescind their franchise agreement due to inadequate disclosure.

Factual background

In February 2014, spouses Claire Giroux and Mitchell Kennedy approached a representative of 1073355 Ontario Ltd. (107) about purchasing a telecommunications consulting franchise. In March 2014, the franchisor delivered an initial franchise disclosure document to Giroux and Kennedy. Over the course of further discussion and negotiation, the franchisor provided additional documents, including an addendum, a financing offer and growth projections. Subsequently, the franchisor provided a second disclosure document, which contained certain updates compared to the first disclosure document. After the prospective franchisees' lawyer had reviewed this document, the franchisees executed the franchise agreement in April 2014. Giroux and Kennedy's franchise operated at a loss throughout its operation, and on April 7, 2016, they delivered a notice of rescission to 107.

The franchisees alleged that there were a number of material deficiencies in the disclosure documents, including the following:

1. Disclosure had not been delivered as one document, but rather through two disclosure documents and the piecemeal provision of various related documents and agreements, contrary to section 5(4) of the AWA.
2. The financial statements had not been prepared in accordance with a minimum review engagement standard in either disclosure document.
3. Neither disclosure document contained the basis and assumptions for the financial performance representations.
4. Neither disclosure document contained the material terms of financing arrangements offered by the franchisor.
5. The disclosure documents omitted material facts, including information about former franchisees, the founder's relationship with the franchisor, past legal penalties and the history of the franchise system.

On the basis of these alleged deficiencies, the franchisees argued they were entitled to a remedy under section 6(2) of the AWA.

Decision of the Ontario Superior Court

The Ontario Superior Court granted a declaration that the franchisees were entitled to rescind the franchise agreement due to the franchisor's failure to provide all material facts, and dismissed the defendants' counterclaim.

The Court granted rescission on the basis that the unaudited financial statements included in the second disclosure document did not meet the required accounting standard. Section 3(1)(b) of Ontario Regulation 581/00 (the Regulations) requires that financial statements be prepared in accordance, at the least, with the standards applicable to review engagements. As the franchisor did not call evidence that its financial disclosure complied with this standard, the Court drew a negative inference that the statements did not comply.

The Court also found that the franchisor's failure to provide information substantiating the earnings projections amounted to a material deficiency. Financial projections do not have to be included in disclosure; however, when they are provided, section 6(3) of the Regulations requires that the information to substantiate the projections must also be available to prospective franchisees. The Court noted that the information provided by the franchisor in the second disclosure document – namely, graphs showing earnings over 31 to 48 months of all franchisees, of franchisees with at least one year of experience and of the franchisees with the top 25% earnings – amounted to financial projections. The franchisor's failure to disclose the information underlying these projections amounted to an infringement of section 6(3) of the Regulations.

Regarding the material facts allegedly omitted from the disclosure documents, the Court held that the second disclosure document contained an accurate list of former franchisees, which meant that the franchisor adhered to the disclosure regulations with respect to this information. The Court noted that the following pieces of information did not need to be disclosed: (a) information regarding the founder of the franchise (even though the founder was a franchisor's associate pursuant to the AWA) because this was not a material fact; (b) past convictions against the founder more than 10 years in the past; and (c) prior ownership history of the franchisor more than 10 years in the past.

Interestingly, the Court rejected the franchisees' argument that disclosure had not been provided in one document at one time. Rather, it found on the evidence that the franchisees had relied only on the second disclosure document, which had been reviewed by their counsel. The Court found the process to purchase the franchise started anew with the franchisor's delivery of the second disclosure document, and that there was no evidence of any confusion between the two disclosure documents.

Key takeaways

The *Giroux* decision is a reminder that franchisors should exercise great caution in preparing disclosure documents to ensure their conformity with the letter of provincial franchise statutes and regulations. Experienced counsel can help franchisors to meet their legal obligations when providing disclosure, and to avoid or minimize potential liability arising from deficient disclosure.