

## ***Mendoza v. Active Tire: Ontario Court of Appeal Tightens Law On Franchisor Disclosure Requirements***

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In *Mendoza v. Active Tire & Auto Centre Inc.*, the Court of Appeal for Ontario reversed a decision of the Ontario Superior Court of Justice and granted rescission to a franchisee under section 6(2) of the *Arthur Wishart Act (Franchise Disclosure), 2000* (the *Wishart Act*).

In the original decision that was overturned by the Court of Appeal, Justice Dow of the Ontario Superior Court of Justice held that certain deficiencies in the franchise disclosure document were not necessarily fatal so as to entitle the franchisee to the two-year rescission window under section 6(2) of the *Wishart Act*. Rather, in assessing whether the required disclosure had been made, Justice Dow focused on whether the franchisee had made an “informed decision” to enter into the franchise agreement.

The two deficiencies focussed on by Justice Dow were i) the absence of a second officer or director’s signature on the disclosure certificate and ii) the delivery of non-compliant financial statements from the prior year. Justice Dow concluded that the “disclosure document provided was not in full compliance with the *Wishart Act* but the deficiencies were not significant or misleading. As a result, my conclusion is rescission is not available to Mendoza under Section 6(2).”

As noted in our discussion of this case in our prior newsletter, Justice Dow’s decision appeared to depart from a strictly objective analysis of the disclosure document’s compliance with the *Wishart Act*, and instead shifted the focus to whether the franchisee made an “informed decision.” Justice Dow’s decision contrasted with prior jurisprudence, which has held that disclosure deficiencies such as the failure to deliver a single disclosure document, the failure to provide financial statements in accordance with the *Wishart Act* and the failure to provide a certificate signed by two directors, are “fatal deficiencies” that entitle the franchisee to rescission under section 6(2).

On appeal, the Court of Appeal for Ontario put to rest any argument that the franchisee’s subjective knowledge or actions are relevant to the analysis of the disclosure document or the rescission rights available to the franchisee. The Court of Appeal clarified that the franchisor’s disclosure obligations “do not change depending on the actions or reactions of a particular franchisee” and that the rescission remedy is not “conditional on the approach taken by a particular franchisee to the disclosed material.”

Part and parcel of this analysis was a rejection of the franchisor’s argument that the franchisee should not be entitled to a remedy under the *Wishart Act* because they initially did not seek rescission based on

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deficiencies in the disclosure document and instead sought rescission later on because the franchise did not do well and the individual appellant regretted his decision. In rejecting this argument, the Court affirmed that “the remedy in s. 6(2) turns only on the failure of the franchisor to deliver a disclosure document. It is not dependent on later conduct of the franchisee.”

In addition to clarifying the general principles above, the Court of Appeal reiterated the rigid requirements under the *Wishart Act* to i) certify the disclosure document with at least two signatures from directors or officers, and ii) to provide compliant financial statements.

## **The Two Signature Requirement**

Where a franchisor has more than one officer or director, section 7 of the regulations to the *Wishart Act* requires a disclosure document to be signed by two persons who are officers or directors.

With respect to the two-signature requirement, the Court of Appeal clarified that the failure to comply is not absolved by the fact that the franchisee had additional information available to it, including knowledge of the directors. The Court explained:

the motion judge discounted the failure to provide two signatures because the individual appellant had met most of the directors and had information about their backgrounds in Part II of the disclosure document. However, this misses the point of s. 7(1)(e) of the Act, which is to give the franchisee substantive rights in damages against the directors and officers who sign the document, and by so doing, to impress upon those who sign the importance of ensuring that the document is complete and accurate.

The Court of Appeal further explained that requirement is “clearly material to any franchise agreement” on the basis that “those who sign are personally responsible for the accuracy and sufficiency of the contents of the disclosure document, and that responsibility is backed up by personal liability to the franchisee.”

This decision removes any doubt that the failure to comply with the two signature requirement is fatal to a disclosure document and will entitle a franchisee to a two-year rescission window.

## **Financial Disclosure Cannot Deviate from the *Wishart Act***

The Court of Appeal also considered the requirement to provide financial statements under section 3 of the *Wishart Act*. Section 3(1) requires that a disclosure document include a financial statement for the most recently completely fiscal year. Section 3(2) provides a limited exception - where less than 180 days have passed since the most recently completed fiscal year and a financial statement is not yet prepared, the franchisor is entitled to deliver a financial statement from the previous year.

In this case, the franchisor had delivered the prior year’s statement two weeks outside the 180 day “grace

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period.” The Court rejected the franchisor’s argument that this late delivery was not material, explaining that it “would mean that franchisors would be free to ignore the statutory requirements regarding the obligation to produce current financial statements, and franchisees would be unable to rely on the protections contained in the Act.”

## **The Takeaway for Franchisors**

The Court ultimately rejected the franchisor’s argument that these deficiencies were “insignificant and not misleading,” instead finding that they “represent material deficiencies and are fatal to the ability of the purported disclosure document to be a disclosure document within the meaning of the Act.” Because deficiencies of this nature will entitle a franchisee to a two-year rescission window, this case highlights the well-known but oft-neglected need for franchisors to engage counsel to ensure that their disclosure documents are compliant with the *Wishart Act*.

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